The Economist

MAY 7TH–13TH 2005

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Politics this week

May 5th 2005
From The Economist print edition

The challenge in Iraq

AP

A new **Iraqi** government was sworn in, three months after a general election, with Dr Ibrahim al-Jaafari, a moderate Shia Islamist, as prime minister, along with 17 other Shias, seven Kurds and—provided that a final clutch of ministries is agreed upon—half a dozen Sunni Arabs. In the past week, at least 150 civilians, security forces and insurgents have died in a wave of fighting and suicide-bombings, including at least 40 in one explosion in the Kurdish capital, Arbil.

See article

Iran's foreign minister told the five-yearly review of the Nuclear Non-Proliferation Treaty that his country had every right to pursue nuclear technologies, including uranium enrichment, and was determined to do so. A spokesman said Iran would soon resume some nuclear activities suspended during negotiations with Britain, France and Germany, which want Iran to give up such technologies.

Three weeks after a terrorist bombing marked the first such attack in the **Egyptian** capital for seven years, a suicide-bomber killed himself and injured foreign tourists in another attack in Cairo; his sister and a female friend were also killed after firing at a tourist bus. Four days later, over 2,000 supporters of the banned Muslim Brotherhood demonstrated in Cairo and elsewhere in Egypt.

Natan Sharansky, **Israel's** minister for Jerusalem and diaspora affairs, resigned from Ariel Sharon's government in protest against plans to withdraw from the Gaza strip.

A state security court in **Oman** convicted 31 people of plotting to overthrow the ruling sultan and install an Islamist government.

A bomb killed at least 14 people in a football stadium in Mogadishu, the capital of **Somalia**, shortly after a speech by the prime minister, Ali Gedi, who was visiting the lawless country's capital for the first time since taking office last year.

Panda play

China offered to send a pair of giant pandas to Taiwan, as part of a reconciliation process. Taiwan was wary, scenting hidden dangers.

See article

On the 30th anniversary of the fall of Saigon, **Vietnam's** prime minister, Phan Van Khai, said he would visit Washington in June—the first such trip by a Vietnamese leader since the war.

North Korea test-fired a short-range missile in the general direction of Japan, reviving fears about the country's missile and nuclear ambitions.

See article

Pakistan captured Abu Faraj Farj al-Libbi, a fugitive said to be the third-in-command of **al-Qaeda**.

See article

Plan B

George Bush continued to campaign for **Social Security** reform. Last week, he used a television address to propose a revised plan that would continue providing benefits to low-income workers, but reduce payments to retirees further up the income scale.

Getty Images

An army judge at the military trial of Private Lynndie England, a central figure in the **Abu Ghraib** prison scandal, rejected her guilty plea. The judge said he was not certain that Ms England knew she was committing an illegal act at the time. The army has an option to bring new charges.

Margaret Spellings, the education secretary, said Utah might lose $76m in federal aid after governor Jon Huntsman signed a law that explicitly places the state's own **education standards** above those of the federal “No Child Left Behind” act. Utah's action is the strongest stance taken by states who grumble that the federal law is not fully funded.

A row over calculating import tariffs on **agricultural goods**, which had held up the Doha round of negotiations on global trade, was resolved between the United States, the European Union, Australia, Brazil and India. Separately, the new US trade representative, Bob Portman, met his European counterpart, Peter Mandelson, for the first time and discussed issues bedevilling the trading partners, including subsidies to aircraft manufacturers.

A small explosive device went off outside the British consulate in **New York**. Nobody was injured.

Decision days

Britain's voters went to the polls in a general election. They confounded opinion pollsters by delivering a slap in the face to Tony Blair's Labour government.

See article

Buoyed by two new opinion polls pointing to a Yes vote, after 20 had said No, President Jacques Chirac renewed his appeal to French voters to ratify the **European Union constitution** in a referendum on May 29th. Mr Chirac insisted that nobody who called himself a European could vote No.

The European Court of Justice surprisingly upheld an Italian law that softened the penalties and scope for charges of false accounting. The law, passed soon after **Silvio Berlusconi** became prime minister, enabled him to escape charges relating to companies under his control between 1986 and 1989.

The American and Italian authorities issued conflicting reports over who was to blame for the killing of an **Italian agent in Iraq** engaged in rescuing an Italian hostage. But the two countries' leaders, Silvio Berlusconi and George Bush, tried hard to defuse resultant tensions after an amicable telephone conversation.

A jaded revolution

AP

During a state visit to **Cuba**, Hugo Chávez, **Venezuela's** president, joined with his host, Fidel Castro, in promoting a “Bolivarian alternative” to the Free-Trade Area of the Americas. The two leaders signed several trade and co-operation agreements.

Mexico's new attorney-general dropped controversial contempt of court charges against Andrés Manuel López Obrador, the mayor of Mexico City. The move allows Mr López Obrador to stand in next year's presidential election.

See article

The parliamentary caucus of **Canada's** Conservative Party gave unanimous backing to its leader, Stephen Harper, to seek an early election by tabling at the earliest opportunity a no-confidence vote against the Liberal minority government of Paul Martin.

See article

Breaking an earlier deadlock, the **Organisation of American States** chose José Miguel Insulza, Chile's interior minister, as its new secretary-general. America's secretary of state, Condoleezza Rice, had backed Mr Insulza during a visit to Santiago.

See article

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Business this week

May 5th 2005
From The Economist print edition

Verizon buys MCI

MCI, an American long-distance telecoms firm, agreed to be acquired by **Verizon** for $8.5 billion. MCI's board rejected a 15% higher offer of $9.8 billion from **Qwest**—the fourth time that a bid from Qwest had been spurned in three months. Verizon's sweetened bid is 25% higher than the $6.7 billion it initially offered, and which MCI accepted, in February.

See article

Nortel Networks recorded a net loss in 2004 of $51m (compared with a net profit of $434m in 2003). The telecoms-equipment manufacturer, based in Canada, said it hoped to see an expansion in sales from the growing telecoms markets in China, India and South Korea.

IBM announced that it will take a pre-tax charge of $1.3 billion-1.7 billion to cut jobs and restructure its business, mostly in western Europe. It expects to eliminate 10,000-13,000 jobs.

The chief executive of **Merck**, Raymond Gilmartin, resigned. The American pharmaceuticals firm was clobbered last autumn by the withdrawal of Vioxx, a hitherto widely used anti-arthritis drug. He was replaced by Richard Clark, a company insider.

The Semiconductor Industry Association reported that worldwide sales of **semiconductors** in the first three months of 2005 had risen by 13.2% compared with the same period in 2004. The SIA had estimated that 2005 would be a flat year, but higher-than-expected sales of wireless handsets and personal computers have pushed up demand.

He stays on, for now

The board of **Morgan Stanley** reiterated its support for beleaguered chief executive Philip Purcell, who is facing a campaign for his removal by a group of former executives and some shareholders. However, the board did change a rule that required the approval of 75% of the board to replace its CEO and chairman; now only a majority is required.

See article

ABN Amro, a Dutch bank, suffered a setback in its attempt to buy **Banca Antonveneta**. The Italian bank's board of directors was replaced with new directors chosen by **Banca Popolare di Lodi**, a rival Italian bank which has a large stake in Antonveneta and which also launched a bid last week.

See article

American International Group said it would restate financial statements for four years, reducing the company's net worth by $2.7 billion (or 3.3%). Lawyers for Maurice “Hank” Greenberg, the insurance giant's former boss who stepped down in March, questioned the move and said that accounting decisions had been “appropriate”.

Several former and current independent directors at **Hollinger International** agreed, without admitting any fault, to a $50m settlement in a lawsuit brought against them by Cardinal Capital Management, an investment firm, on behalf of shareholders. The suit alleged that the directors did not do enough to stop former chief executive Conrad Black from allegedly looting the company.

This season's must-have

Neiman Marcus, a chain of luxury department stores, announced that it was being bought by two private-equity firms in a deal worth some $5.1 billion. The company is famous for catering to the well-to-do: its last Christmas catalogue included a limited-edition Maserati sportscar. Some analysts doubt if Neiman's recent growth (profits in 2004 were almost double those of 2003) is sustainable.

See article

Kirk Kerkorian offered to buy 28m shares in **General Motors** through his Tracinda Corporation for $870m, boosting the struggling carmaker's share price by 18%. The deal will increase the billionaire investor's stake in GM to 9%.

Adidas decided to sell its struggling Salomon winter-sports unit to **Amer Sports**, which is based in Finland and owns well-known sportswear brands including Wilson. The price was *euro*485m ($625m).

Fresenius Medical Care, a German firm that is the world's largest provider of dialysis products, unveiled a $3.5 billion buyout of **Renal Care Group**, based in Tennessee. The merged group will treat 156,000 patients each year at 2,000 clinics.

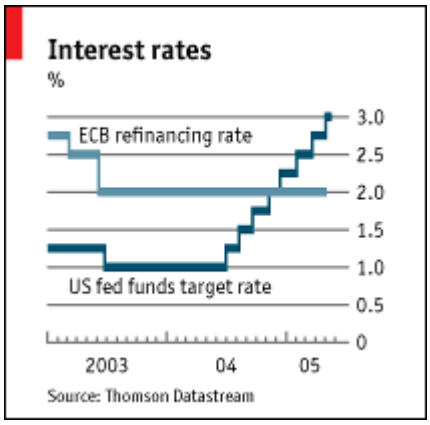
Arcelor, the world's second-largest steelmaker, posted a 300% rise in first-quarter net profit, which stood at *euro*934m ($1.2 billion).

The price of **oil** fell below $50 per barrel for the first time since mid-February.

Fairly predictable

America's Federal Reserve put up its key **interest rate** by one-quarter of a percentage point to 3.0%, the highest rate since September 2001. The European Central Bank, which sets rates for the euro area, kept its key interest rate at 2%. Both central banks said that inflation remained a concern.

See article



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Britain's election

Ouch!

May 5th 2005
From The Economist print edition

Tony Blair did a lot less well than expected in the election. That may not be a good thing

Getty Images

READING the mood of British voters has proved easier than predicting the result of this election. It has been clear for some time that what a great many people wanted to do was to punish Tony Blair in a way that did not result in a return to power for the Tories. While the Liberal Democrats claimed that a vote for them was the way to realise this objective, in practice it was something that the British first-past-the-post system is ill-calibrated to achieve. Yet this is just what, as *The Economist* went to press, seemed likely to happen: the return to power of a Labour government, but one with a markedly smaller share of the popular vote and a majority in parliament that, although workable, undermines the authority of a prime minister whose own unpopularity had done so much to damage his party's standing.

There can be little doubt about what went wrong for Labour: too many of its natural supporters could not forgive Mr Blair for having taken his country into a war that many Britons (though not this newspaper) opposed. By staying at home or voting for the anti-war Liberal Democrats, their choice blended with a surprisingly successful anti-immigration campaign by the Tories to give Mr Blair the bloody nose that many people have been longing to deliver.

Deep disappointment

That is the immediate cause of the blow to Mr Blair; but there are deeper reasons too. First, although he has transformed British politics, people feel he has not done enough to change the country. In a way, that's unfair. By hauling the Labour Party on to the centre ground, he made it electable and forced the Tories to compete for what had been their own political territory. As a result, the sharp ideological swings that characterised British politics for most of the 20th century now seem part of an ancient and (happily) lost tradition. This is a huge and positive change; yet because it does not have a direct effect on people's lives they do not necessarily perceive it as one, and therefore regard its architect as a bit of a let-down.

Second, Iraq contributed to that sense of disappointment because so much of Mr Blair's second term was taken up with the war. The difficult business of being George Bush's best political friend at this tricky juncture absorbed a great deal not just of the prime minister's time and energy, but also of his political capital.

And there is a third reason why Britain lost faith in Mr Blair, which goes to the heart of both the man's mission and his personality (see article). Because of his uneasy relationship with his own party, he has needed to convince many different people of many different things. In domestic policy, that meant creating the appearance of change, while avoiding the difficult choices that real reforms inevitably involve. Over Iraq, it meant building an elaborate legal edifice to satisfy Labour MPs, when the objective of regime change had already been all but decided upon with President Bush.

Before the election Mr Blair said that, if re-elected, he would serve a full term. Over the next few days, it will become clear whether or not that is realistic; but his resilience should not be underestimated, nor his desire to make more of a mark on the fabric of national life than he has done so far. He might go earlier, and hand over to Gordon Brown, the chancellor. But whether he stays or goes, the challenges facing this

weakened government will be the same. The question is whether it will be capable of rising to them.

So much to do

The first thing that either Mr Blair or Mr Brown must do is to put the country on a more stable fiscal footing. Under them, Britain's economy has performed remarkably well, but it may not go on doing so for much longer. The government's spending spree has transformed a healthy surplus into an increasingly worrying deficit. Mr Brown's instinct will be to raise taxes, but that would further undermine Britain's competitive advantage. It would be far better to slow down the huge spending increases planned for the public services, most of all the National Health Service (NHS), over the next three years. But the chances of that happening are even lower than they were before the election.

Second, Mr Blair's hard-won health-service reforms need to be entrenched. He has shaken up an inefficient state-controlled monolith by introducing both an internal market—hospitals get paid per patient they treat, instead of through a block budget—and by letting the NHS participate in the external market—the state pays private companies to operate on NHS patients. But following through with those reforms will be hard with a small majority. And, despite Mr Brown's apparent conversion to the cause of reform (see Bagehot), he has less at stake than Mr Blair.

Third, Mr Blair ought to complete his constitutional reforms. Despite some notable achievements, his failure to reform the House of Lords is shameful. He got half-way there, by chucking out most of the hereditary peers; then, realising that a democratically-elected second chamber would undermine the power of the House of Commons, he stopped—leaving a part-hereditary, mostly-appointed mess. If his constitutional reform programme is not to be judged a hypocritical failure, he needs to set up a legitimate, elected second chamber. This is one area where a damaged, eager-to-please Mr Blair might end up doing more than when he was in his pomp. Even so, the House of Commons may still block it.

Elsewhere, political weakness is likely to result in worse, not better policies. Tackling the impending pensions crisis by raising the retirement age will be even harder; as will reducing the vast invalidity benefits bill. The prospect of sorting out schools that have been given lots of extra money to little effect also becomes more remote.

Some of Mr Blair's many faults were the product of arrogance. Yet by diminishing him, Britain's voters have almost certainly ensured they will have a more timid, less radical government. There will be a price to be paid for the fleeting—if genuine—satisfaction of wiping the grin off Mr Blair's face.

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Russia and the West

Victory Day remembered

May 5th 2005
From The Economist print edition

But parades in Moscow should not stop the West confronting Russian autocracy

Magnum Photos

IN THIS year of so many anniversaries, next week's gathering of more than 50 heads of state and government in Moscow will be especially charged. Vladimir Putin, Russia's president, is staging a grand parade in Red Square to commemorate Victory Day, marking in style the 60th anniversary of the Allied defeat of Nazi Germany in May 1945. Like those of 60 years ago, next week's celebrations will be heartfelt and genuine. And yet some of Mr Putin's guests will approach the jamboree with mixed feelings.

Nobody should belittle the sacrifices the Soviet Union made to win what Russians call the Great Patriotic War. The Soviet Union lost some 27m people in the conflict, more than all the other allies put together. But next week's anniversary will still be bitter-sweet. For the people of central and eastern Europe, May 1945 marked the moment they escaped Hitler's murderous grip, only to be imprisoned for half a century in a dictatorial communist empire after Stalin drew an iron curtain across Europe's heart. Eight of the countries subjugated by the Soviet Union after the war are more inclined to celebrate their first anniversary of membership of the European Union than the false liberation of 1945. For them, joining the EU represented the logical culmination of the tearing-down of the iron curtain in 1989. Two Baltic heads of state have duly refused to go to Moscow for next week's parade.

It is not surprising that the history of so cataclysmic an event as the second world war should still cast a shadow everywhere today. But at least in most countries of Europe, people have come to terms with, and in many ways moved beyond, that history—something the European Union by its very existence seeks to symbolise. Germany has fully admitted the sins of its past: next week, for instance, it will open a new Holocaust memorial in Berlin (see article). Even Japan, slow as it is to accept its faults, has repeatedly apologised for its wartime record. The exception is the host of next week's celebration: Russia. And its failure to come clean about the iniquities of its own past is part of a wider story that helps to explain why post-Soviet Russia remains so prickly and troubling.

Mr Putin calls himself a democrat. And yet he recently declared that the collapse of the Soviet Union was the greatest geo-political catastrophe of the 20th century. He has also sought to justify the 1939 Nazi-Soviet pact that led to the annexation of the Baltics and the division of Poland. It is hardly uncommon for nations to glorify their wartime histories (think only of Britain's jingoistic tabloid press), and perhaps it is forgivable. But in the memory of too many Russians a justified pride in having vanquished Hitler is mingled with a misplaced nostalgia for the days of “greatness” (and terror) under Stalin's own dictatorship (see article). It is one thing to acknowledge that the living standards of many ordinary Russians have suffered since the demise of the Soviet Union. It is quite another to damn the freedom and democracy that were then won by eastern Europe and many (but by no means all) former Soviet republics—and to suggest, by implication if not by actions, that it might be a good thing if these were reversed.

As it happens, the tearing-down of the iron curtain and the dissolution of the Soviet Union were achieved remarkably peacefully, considering Russia's turbulent history. Moscow harrumphed when former vassals joined first NATO and then the EU, but it did not seek actively to stop them. Nor was Mr Putin able, over the past two years, to prevent the spread of “democratic revolutions” through such places as Georgia, then Ukraine and, most recently, Kirgizstan. But the Russians are still interfering, politically and militarily, in a string of neighbouring countries that were once under Soviet control. They have still not signed border treaties with two of the three Baltic countries (see article). To the neighbours, Mr Putin's Russia looks dangerous—even if, to the West in general, a weakened Russia is far from the threat it was in cold-

war days.

Living with a new bear

Russia's failure fully to acknowledge its past is more than a case of post-imperial twitching in its near-abroad. It is also part and parcel of Mr Putin's shift from liberal democracy towards authoritarianism. As his presidency has progressed, the independent media have been muzzled, elections rigged and any hints of opposition neutered. This might seem a matter primarily for Russians to fret over, but it also troubles neighbours that have too often suffered from Russian attention. Foreign investors are worried too. The government's attack on the Yukos oil company and its erstwhile boss, Mikhail Khodorkovsky—whose trial verdict was last week conveniently postponed so as to come after Mr Putin's Victory Day parades—has demonstrated with an awful clarity both the lack of any independent rule of law and the arbitrariness of the Russian state's intervention in business. To western Europeans who are increasingly reliant on Russia for energy, this too should be a matter of great concern.

As they gather in Red Square next week, western leaders should be mindful of these things. In recent years, Mr Putin—like many Russian leaders before him, including Stalin—has proved masterly at playing western governments off against each other. As America disengages from Europe to face challenges in the Middle East and Asia, leaders such as Germany's Gerhard Schröder and France's Jacques Chirac have been too anxious to engage Mr Putin, to cultivate their commercial ties, to soften any criticism of his democratic credentials, and to belittle the concerns of countries in Russia's near-abroad.

This eagerness not to offend is a mistake. Russia has its pride and special sensitivities. But the countries of the West would be doing both themselves and the Russian people a favour by speaking firmly, with one voice, on human rights, democracy, the rule of law and the brutal war in Chechnya. They should urge Mr Putin to confront and transcend the dictatorship of memory by normalising Russia's borders with the Baltic states, to re-open archives that reveal the terrible truth of the communist tyranny, and to abandon any atavistic dreams of empire. Only then will it be possible to say, on some future Victory Day, that Europe is at last whole and free.

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Telecoms mergers

Healthy network effects

May 5th 2005
From The Economist print edition

America's telecoms sector is consolidating, but that is good, not bad, for competition

IT LOOKS suspiciously like a return to the past. In 1984 a federal judge ordered the break-up of AT&T, America's telephone monopoly, on antitrust grounds to inject some sorely needed competition into the country's telecoms industry. “Ma Bell”, as AT&T was affectionately known, was split into a group of regional local phone firms and a long-distance company, which retained the AT&T name. In recent years, a wave of mergers seem to have reversed that break-up. This week MCI, the former bankrupt WorldCom, accepted an $8.5 billion takeover bid from Verizon, a former “Baby Bell” spun out of AT&T all those years ago. Verizon won control of MCI only after a long and controversial bidding battle with Qwest, the smallest of the Baby Bells (see article). This leaves America with two mammoth phone firms, Verizon and SBC—another former Baby Bell that bought the remnants of AT&T in January—carving up most of the country. Have the past 21 years been a waste of time? Should America's regulators intervene again?

Despite appearances, the answer to both questions is a resounding no. America's telecoms industry may be consolidating, but this is now a welcome development. Since the 1984 break-up of AT&T, the telecoms industry has changed out of all recognition, transformed by a cornucopia of new technologies beyond mere telephone calls, and a herd of robust new competitors. Ironically, the recent mergers among former Baby Bells are to be cheered precisely because they are due to competition and herald yet more rivalry to come.

The new “telecomglomerates” produced by the mergers should no longer be distracted by spending millions each year lobbying legislators and regulators in Washington for favourable treatment, their principal form of competition in the past. Instead, they should be free to compete nationally, and not only against each other but against a swathe of new rivals. Today, these challengers come in the form of cable companies and wireless firms. Tomorrow, competition will be from broadband-wireless firms and companies using power lines. All plan to use their networks to stream internet, phone service and television programming. Firms with mobile-phone subsidiaries will bundle those services into the mix as well.

The mergers represent a natural evolution for the industry. Telecoms firms staggered from the bursting of the tech and telecoms bubble in 2001 as the walking wounded of corporate America. They had not only over-invested recklessly, but had blindly ignored the threat of newer, cheaper technologies that would turn their main product, voice calls, into a commodity. The cost of calls plummeted, new rivals cropped up everywhere, and people began a mass migration to mobile phones. Mergers among the over-extended Baby Bells became inevitable. For the same reasons, a wave of mergers among Europe's telecoms firms can also be expected soon.

Both the SBC-AT&T and Verizon-MCI deals must now go before the Federal Communications Commission (FCC), the first real test for Kevin Martin, its new chairman, who took over in March. The deals also come just as Congress prepares to re-examine America's 1996 Telecoms Act. The FCC and Congress both ought to recognise that the industry, transformed by technological change and a wave of new entrants, no longer needs a heavy regulatory hand. The FCC should approve these two big mergers. And Congress ought to scrap the outdated rules of the 1996 act, freeing firms to give consumers whatever form of voice, video or other services they want.

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Iraq's new government

Now try to reach out

May 5th 2005
From The Economist print edition

The insurgency cannot be tamed by force alone

Get article background

Getty Images

THE government sworn into office this week in Iraq has made an unconvincing start. Much of the momentum created by the success of the general election at the end of January has fizzled. The new prime minister, Ibrahim al-Jaafari, himself an unknown quantity as a leader, has sensibly included a wide cross-section of Iraqis from across the sectarian spectrum, but it is unclear yet whether any of the Sunni Arabs brought into government have the weight within their own community to persuade many of the insurgents, who are almost entirely Sunni Arabs, to lay down their arms.

A fresh wave of violence in the past week has showed that the insurgency is ever-deadly (see article). And yet a leading Shia in the new order has suggested that, far from seeking to negotiate with the insurgents so as to peel off aggrieved secular nationalists from the al-Qaeda-minded fanatics, the answer is to annihilate the lot of them. More worryingly still, many of the newly dominant Shia politicians seem reluctant to let anyone who was a Baathist during the Saddam era (meaning practically anyone from the middle rank upwards) have serious jobs in government or the security forces—a recipe for keeping Sunni resentment on the boil.

Dr Jaafari and his new team still have a fair chance of putting things right. He is right to see the steady Iraqification of the forces as the key to beating off the rebels. After a patchy start, that process is going quite well. He must reject calls to reverse the policy of his predecessor, Iyad Allawi, who sought to bring back veterans from Mr Hussein's army and police to put backbone into the revamped forces. But by far his most vital task is to reach out to Sunni Arabs, less than a fifth of the total population but a much bigger slice of Baghdad's middle class, to make them feel part of the new deal. A more hopeful sign is that some of the Muslim Scholars' Board, a powerful group of Sunni clerics who have hitherto endorsed the insurgency, have told Sunnis to join in the drafting of a new constitution.

Don't give up

That, alongside the challenge of holding off the insurgents, is the new government's chief quest. Again, Dr Jaafari must include a good clutch of Sunni Arabs as well as Kurds in the drafting committee. The new constitution, due to be ready by August but with a six-month extension if need be, must reflect a theme of tolerance and respect for diversity that has been absent in Iraq for the past half-century. Though Dr Jaafari is an Islamist and the constitution is sure to enshrine Islam as a source of law, it would be unwise—if Iraq's Kurds, Christians and many secular-minded Shias and Sunnis are to be reassured—to wrap the country in a tighter Islamist strait-jacket. And it is essential that the new Iraq is granted a wide measure of federalism, not just to accommodate the Kurds (with the disputed city of Kirkuk having a special status) but also to give Iraqis more local freedoms and responsibility.

So far, there has been little sign of Iraq's much-mooted fragmentation along sectarian lines. Baghdad and its environs, where nearly a quarter of Iraq's 27m-odd people dwell, is too mixed up to be picked apart. Even the Kurds, who have enjoyed more than a dozen years of near-independence since the first Gulf war, seem to accept that Iraq can be shared. Despite the difficulty of bringing prominent Sunnis on board, the new parliament and the new government do reflect the country's diversity, and so do the

revamped security forces.

Broadly speaking, there are two possible outcomes. The inflexibility of Islamising Shias astride the new government could polarise the country still more, set the country's three main communities at each others' throats, and send Iraq into a downward spiral of even bloodier mayhem. Or a subtler approach could put the country on an inevitably bumpy path towards tolerance, pluralism, decentralisation—and the steady containment of violent opposition.

The happier outcome won't happen fast. Iraq is trapped in a catch-22: its government cannot rebuild the country and its institutions unless the insurgency is contained, yet it cannot easily contain the insurgency until it can persuade people that they are reaping the benefits of rebuilding. Foreign forces will be needed for some time yet, though the new government is perfectly entitled to ask them to leave if it thinks they have become part of the problem. Suicide-bombers will continue to sow anger, fear and a thirst for communal revenge. Above all, Dr Jaafari needs to be clever as well as courageous in order to persuade his Shia co-religionists that the best way for them to enjoy their rightful fruits of power is to share them out.

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German capitalism

Bogus backlash

May 5th 2005
From The Economist print edition

Attacks by a leading German politician on investors have been hysterical and misguided

Get article background

FLPA

THE metaphor of the swarm of locusts devouring all in its path is as old as the Bible. But when politicians, particularly German ones, use it today to attack groups whose behaviour they don't like, it is hard not to be reminded of Nazi propaganda against “social parasites” and “blowflies”. Such comparisons, even though they are by no means signs of anti-Semitic thinking, are especially regrettable when uttered so close to the anniversary of the end of the second world war.

Yet a lack of linguistic sensitivity is not the most unfortunate aspect of recent remarks by Franz Müntefering, chairman of Germany's governing Social Democratic Party (SPD), in which he condemned certain financial investors as “swarms of locusts that fall on companies, stripping them bare before moving on”. By starting a heated “capitalism debate”, he has triggered an anti-business and anti-reform backlash that might be hard to stop. That could be immensely damaging to both Germany and Europe (see article).

Foreign observers are as bemused as they are alarmed by the debate and its fall-out. After Mr Müntefering's attack there were calls in Germany to boycott “socially irresponsible” companies and to introduce legal limits on top executives' salaries. Last week, the press found an internal SPD memo listing a dozen “locusts”, mostly (American) private-equity firms, which are said to have stripped bare German companies.

Much of the rhetoric can be discounted as electioneering of the most desperate kind. The SPD is scared that it might lose regional elections in its heartland in North Rhine-Westphalia, Germany's most populous state, on May 22nd. Attacking capitalists may give it a chance to mobilise long-time SPD voters, who otherwise might stay at home or prefer a new left-wing party that will put up candidates for the first time. And Mr Müntefering's offensive firmly positions the SPD as an alternative to the Christian Democrats, who hope to win the next federal elections in September 2006 by embracing far-reaching economic reforms.

A dangerous debate

Yet the intensity of the debate shows that Mr Müntefering has hit a chord with Germans. Never enthusiastic about Chancellor Gerhard Schröder's Agenda 2010 package of economic reforms, many see recent slow growth and persistently high unemployment as proof that moves to a supposedly more Anglo-American-style, less-regulated economy are not working. That many German companies are, for the moment, nicely profitable only adds to popular indignation. Germans also resist the idea that they will have to give up even more of their cherished social-market model, and the rules and government benefits that underpin it, if they want to stop jobs moving abroad and cheap labour from coming in. Almost 60% agree with at least some of Mr Müntefering's arguments.

The question now is whether the debate will have any lasting consequences. In Germany, such political fits typically die down as fast as they appear. But this time it could be different, thanks to the current situation. If the SPD loses North Rhine-Westphalia, there could be a revolt within the party against Mr Schröder and his reforms. If the party hangs on to power after all, Mr Schröder might be tempted to add

a dose of anti-free-market rhetoric to his bid for re-election in 2006.

In any case, some within the SPD are busy working on an alternative to Agenda 2010 which would reportedly include higher taxes on dividends and capital gains as well as on inheritance. Labour-market reform would be modified, for instance by relaxing conditions under which long-term unemployed have to accept jobs if they do not want to lose benefits.

Even if none of this comes to pass, the “capitalism debate” has already done much damage to any faith that Germany is really willing to tackle its economic problems. It certainly has not made the country more attractive to investors, foreign or domestic. Even a future CDU-led government might now be more careful when it comes to further economic reforms.

But there might just be a silver lining to this affair. It clearly shows how bad a job German leaders, in both government and opposition (and, it must be said, in business and finance as well) have done of explaining the need for reforms. Just like France with its anti-European spasm ahead of the May 29th referendum on the EU constitution, Germany may have to go through such an episode to understand finally that its economic model is past its prime, and needs an overhaul. The underlying truth is already clear: the country needs a freer, more flexible form of capitalism, not a hunt for scapegoats.

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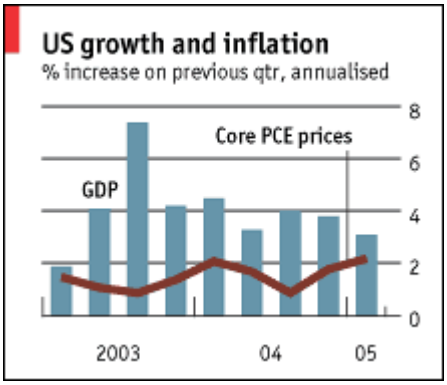
The global economy

Stagflation, the remix

May 5th 2005
From The Economist print edition

It's not the 1970s, but the modern version could prove equally tricky



LIKE the disco era it dominated, stagflation has a distinctive beat: slow growth, rising inflation, high oil prices and weak labour markets. In the 1970s this nasty combination haunted the global economy. Could it be making a comeback?

Today's world economy does seem to be playing some similar tunes. In the statement accompanying its latest interest-rate hike on May 3rd, America's Federal Reserve fretted about both price pressure and a slowdown in spending. On May 4th, the European Central Bank kept interest rates unchanged, but worried aloud about oil prices and slowing growth.

The evidence is mounting that global growth has slowed. In America, output grew by an annualised 3.1% in the first three months of 2005, the slowest pace for two years. More recent figures, from weak retail sales to soggy consumer confidence, suggest this “soft patch” may be getting softer by the day. In Britain, the latest numbers—in retail sales and manufacturing—point to weaker growth. And in the euro zone, sluggish economies are looking ever more lethargic.

Yet even as growth is slowing, price pressures are looming. In America, consumer prices rose 3.1% in the year to March, up from 1.7% a year ago. In Britain, inflation jumped unexpectedly in March. And in the euro zone, consumer prices are still rising faster than the 2% goal that the European Central Bank targets. With output slowing and inflation stubborn, it is small wonder that the concerns about stagflation are back in fashion.

In fact, today's version of stagflation bears scant resemblance to the 1970s. In 1979, for instance, America's core inflation, which excludes oil and food, was rising at over 7% a year, while the economy grew barely more than 1%. Recent core inflation, at 2.2%, is only just above the central bank's comfort zone, while GDP growth is pretty close to the economy's sustainable rate. There is a tad of “flation”, in other words, but not much sign of “stag”. The euro zone, by contrast, has plenty of stagnation, but—despite the ECB's nervousness—there is little sign that its inflation is getting out of control (see article).

Just because things are not as bad as the 1970s does not, by itself, give much cause for comfort, however. How far history repeats itself hinges on two other factors. The first is central bankers' determination to retain their credibility as inflation fighters. The 1970s stagflation resulted, in large part, from extended periods of loose monetary policy pursued to accommodate the demand-crippling effect of oil shocks by printing money. The credibility-obsessed folk at the ECB clearly have no intention of repeating that mistake.

But the Fed's governors have played a riskier game. They have, thus far, run an extremely loose monetary policy—even after this week's rise, real interest rates are barely positive. But thanks to the central bank's reserve of inflation-fighting credibility, long-term inflation expectations have barely shifted. At issue is how long that remains the case. At the very least, the measured march to higher rates must continue unabated.

The other wild card combines labour costs and productivity growth. In the 1970s, productivity growth fell sharply and unexpectedly. Added to this, strong trade unions, little international competition and those accommodating central bankers created a pernicious wage-price spiral. There is little of this dynamic today. Although productivity growth has slowed from its recent peaks, it has not slumped. Global

competition has left little room for excessive wage demands. This suggests that a return to classic stagflation is unlikely.

Stayin' alive

But the modern remix still poses problems. Steering monetary policy when growth is slowing and prices are accelerating is never easy. It is particularly hard in today's unbalanced world economy, where too much depends on continued spending by American consumers who, in turn, are counting on an unsustainably frothy housing market. At some point, America's heavily indebted consumers will need to cut back spending. And when that happens, those in the rest of the world will have to start spending more to keep the world economy growing. The real risk is that Washington's central bankers will be too worried about stagnation and Frankfurt's too worried about inflation to allow that to happen.

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About sponsorship

Letters

May 5th 2005
From The Economist print edition

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Not as simple as it looks

SIR – It is deceptive and dishonest to equate a "flat tax" with a tax that is simple to administer ("The case for flat taxes", April 16th). As your article points out, but then blithely ignores, any tax that allows for personal exemptions or a threshold would have to keep track of an individual's income in the same way as a progressive income tax. Only a flat tax without any exemptions that can be taken directly from every payroll cheque would be truly radical. Moreover, the current buzz surrounding a flat tax as a simplifying measure is just a naked attempt to drum-up support for cutting taxes for the wealthy while raising them on the rest.

Travis Collier
Los Angeles

SIR – Computing a progressive income tax requires a subtraction, a multiplication and an addition. Computing a flat tax eliminates the addition. Depending on the difficulty of computing the taxable income (and any tax credits) a simple tax can be steeply progressive and a flat tax can be wildly complicated. Advocates of lower marginal tax rates for the rich consistently conflate the two independent ideas.

Charles Haspel
Miami Beach, Florida

SIR – In India, we have a progressive tax system and a multiplicity of exemptions that distort taxpayers' behaviour the same as elsewhere. However, our system is counter-productive as it also teaches people to avoid and evade taxes and encourages a whole range of activities by taxpayers and taxmen that includes corruption, harassment, intimidation and downright fraud. The last decade has seen the abolition of wealth tax, estate duty and gift tax and a consolidation of tax rates with no adverse effect on tax revenues. Bureaucratic re-engineering of the economy through multiple tax rates is a foolish hope, which is slow in fading. A flat rate for income tax, VAT, customs duty and excise duty would eliminate corruption, encourage compliance, make for better revenues and improve governance.

Gautman Pingle
Hyderabad, India

President Rice?

SIR – In light of Lexington's intriguing report on the Republican Party's efforts to capitalise on its history as the party of Abraham Lincoln, I find myself wondering: will Dick Cheney decide his heart condition warrants resignation in late January 2007 (Lexington, April 23rd)? That would give George Bush the opportunity to appoint Condoleezza Rice as the first non-white and the first woman to the vice-presidency. It would also give the GOP a head start on the 2008 campaign and give Ms Rice a chance of serving two terms.

Mark Shulman
White Plains, New York

SIR – You hint that the Republicans are turning their backs on the "southern strategy". That strategy attempted to convince poor whites to vote against their own interests by appealing to prejudice against

blacks. The new approach attempts to convince blacks to vote against their own interests by appealing to prejudice against gays. The details have changed, but make no mistake: it's the same strategy.

Matthew Levine
Philadelphia

SIR – Blacks may well have helped swing the election in Ohio, but Republicans have little chance of making further inroads with the black electorate as long as the community feels that many of its poorest (and mostly Democratic) voters in Florida and Ohio were denied the chance to vote. In these states, Republicans actively sought to dampen the black vote by placing an inadequate number of voting facilities in black precincts and then challenged black voters who actually used them.

Julian Brown
Arlington, Virginia

South Africa's liberal voice

SIR – You are quite correct in saying that "the most unhappy whites, in [South African] politics, are undoubtedly the liberals" ("If only the adults would behave like the children", April 23rd). There are several reasons for this polarisation. Firstly, there is no doubt that the ANC has made deliberate attempts to airbrush the role of white liberals out of anti-apartheid history. Then, too, instead of the hoped-for democracy, the ANC plays the role of a dominant one-party state aimed at controlling all the levers of power, has attacked the "mindset" of the judiciary, and is intolerant of the role of the official opposition. Added to these, as you mention, is the totally unacceptable attitude of President Thabo Mbeki towards the HIV/AIDS pandemic, and his ongoing sponsorship of Zimbabwe's president, Robert Mugabe.

Helen Suzman
Johannesburg

Non, non, non

SIR – Charlemagne writes that: "France might instead lapse into a long-term obstructionism" (Charlemagne, April 23rd). From Turkey's membership to farm subsidies, from labour market reforms to opposing fairer tax rates, it seems a bit odd to be using the future tense in this regard.

Benjamin Staveley
Munich

Securing a seat

SIR – Membership of the UN Security Council should have less to do with an applicant's moral standing (otherwise half of the current permanent members should resign) than to do with its contribution to the international community ("A collision in East Asia", April 16th). Japan and Germany contribute around 20% and 10% respectively to the UN budget (only America pays more). China, a permanent Security Council member, pays around 1%. In the International Monetary Fund, Japan and Germany subscribe to 6.3% and 6.1% of the IMF's working capital, whereas China's share is 3.0%. The international community would clearly benefit by an increased contribution from two wealthy, pacifist nations.

Vincent Wei-cheng Wang
Richmond, Virginia

Marriage in Canada

SIR – In a recent article on Canada you note that "Another 33 Liberals defied [Paul] Martin and voted with the Conservatives to kill a government bill recognising same-sex marriage" ("The strange death of Liberal Canada?", April 16th). This is not what occurred. In fact, 33 Liberal MPs voted with the Conservatives, but the bill was not defeated as the government had enough supporting votes from the Bloc Québécois and the New Democrats.

Patrick Quealey
Ottawa, Canada

Ebb and flow

SIR – Together with FILTH (Failed in London; Try Hong Kong), the traditional expat is certainly in decline ("In search of stealth", April 23rd). Today, in the new global economy, traditional expats are being replaced by youthful adventurers seeking their fortune, with commensurately higher risks, not unlike their forebears in the 19th century. Hence, given the challenges of doing business in Shanghai, the growing prevalence of FISHTAIL (Failed in ShangHai; Try Again In London). I think that in the 21st century, the flow of FILTH will be quite easily surpassed by the flapping of FISHTAIL.

Roger Owens
Shanghai

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Iraq

New team, old terrors

May 5th 2005 | BAGHDAD
From The Economist print edition

AFP

As its temporary government at last takes office, Iraq looks as fragile as ever

Get article background

THREE months after Iraqis braved the bombers and turned out to vote, there is little joy left in the memory. The weeks after the election saw a relative lull in violence, punctuated by moments of exceptional viciousness. In February and March, according to American figures, attacks on coalition troops dipped to 35 a day, from a pre-election figure of 140. Attacks on the Iraqi Security Forces (ISF) were also down, though less markedly. But the past fortnight has been among the bloodiest since the war's official end two years ago.

On May 4th, more than 60 people were killed and 150 wounded in Arbil, the capital of Iraq's Kurdish region, after a suicide bomber detonated himself outside a police recruitment centre. The next day a similar attack on a recruitment centre in Baghdad claimed at least 13 lives. The killings marked a murderous week following the naming of the new government. On April 29th at least 17 car bombs, most in Baghdad, killed over 50 people. Around 600 Iraqis were killed by insurgents in March, according to the government, including around 150 members of the ISF.

On April 20th, 57 bodies were fished from the Tigris river downstream of Madaen, south of Baghdad; locals were reported as saying that hundreds remained in the water. Days before, the government had reported the kidnapping of 150 Shia men and women by insurgents in Madaen; a massacre appeared to have taken place. And it had, but one more shocking than a single slaughter. The killing in Madaen seems to have occurred over several months, unknown to the American troops stationed nearby or to their Iraqi allies.

Some analysts are predicting a civil war, either after the coalition's troops leave the country, or to hasten their going. Wiser heads urge caution. Throughout the war, they say, journalists and, less forgivably, the American officials who brief them, have jumped to conclusions based on the flimsiest of evidence—often the Americans' own casualty rate. The truth is more complicated.

Military history suggests that, failing the capture of an important leader or an equivalent setback, insurgencies need to be measured in cycles of not less than a year. Such an exercise requires much data, including some unavailable in Iraq. The government only recently began releasing numbers for Iraqi civilian deaths. American officials have made little effort to distinguish successful from failed attacks,

major from minor attacks, or politically motivated from criminal attacks; though they estimate that criminals perpetrate 80% of the total violence. As a result, says Anthony Cordesman of the Centre for Strategic and International Studies in Washington, DC, sound forecasts are nigh-impossible: “Everyone's looking at the *tsunami*, no one's looking at the tide.”

About the insurgents, only the following is certain. They include a mix of Iraqi nationalists—many of them former supporters of Saddam Hussein's Baath party—and *jihadis*, some of them foreign fanatics. Both groups employ part-time assassins and other hirelings with a grudge against the occupation forces, known to coalition officials as POIs, or “pissed-off Iraqis”. Currently, both these groups are predominantly Sunni Muslim (though, last year, Muqtada al-Sadr led a Shia insurgency). As in Madaen, most insurgents are localised. American officials say about 70 such groups exist, but they are probably guessing. Some central organisation exists; Abu Musab al-Zarqawi, a well-organised Jordanian *jihadi*, may be chiefly responsible.

The nationalists and the *jihadis* have no common aim beyond the expulsion of the coalition and the collapse of the government it has helped establish. As the nationalists settle on longer-term aims—either to re-establish the secular Baathist state, or to negotiate terms with the government—differences between the two will emerge. Most analyses of the insurgency vary according to the extent to which this tension is thought evident.

Analysing the insurgency

Official America's analysis begins with the successful conduct of the election. It was not peaceful, with 210 recorded insurgent attacks that day, including nine suicide bombs in Baghdad. Yet turnout was over 60%, and only eight polling stations came under direct attack. This, American officials say, represented a triumph for the ISF, who policed the poll, and the country's peace-hungry majority; and it was a shock to violent nationalists.

As a result, those officials claim, the next few weeks saw a lull in the insurgency and an increase in talks between coalition and government officials and men who claimed to represent the insurgents. Some nationalists swung behind the government; for example, a statement was issued at the nationalist-leaning Um al-Qura mosque in Baghdad urging Sunni Arabs to join the police. Subsequent attacks, this analysis concludes, are mostly the work of criminals, off-message nationalists or *jihadi*s. Mr Zarqawi, in particular, has been credited with a series of atrocities.

Others scoff at this. Sure, the Iraqi security forces and their foreign sponsors managed to limit the violence on polling day, they say, but only by sealing borders and closing roads—in short, by shutting down the country. And why should the insurgents risk a major setback at such an overpoliced time? Unlike the coalition troops, whose political leaders want them home, the insurgents have the luxury of time. And moreover, after a massive increase in violence in the months before the election, the insurgents needed to rest and re-arm. Thus they passed January and March—in Damascus, perhaps, or even Amman—before resuming the onslaught in April.

Either way, the insurgency has lost none of its potency in the short term. Nor is there any dispute about the insurgents' improved professionalism. Recent attacks in Baghdad and Mosul—the first and second cities in Iraq and the most violent—have featured several staggered blasts, aimed to kill and maim both the initial targets and their rescuers.

The progress of the ISF—the main focus of the coalition's efforts in Iraq—is less certain. In the conflagration of October-to-January, it emerged that few were ready to stand and fight. Across the country, police shed their uniforms as insurgents seized their stations. With greater American effort, some half-decent troops have since emerged. Iraqi soldiers have begun patrolling Haifa Street, one of the most violent in Baghdad. Six months ago, when American marines launched an attack on Fallujah, the ISF had around three battalions fit to take a backward role in the operation. They could probably now call on two, or perhaps three, times that number. But, with few heavy arms or armoured vehicles, and still heavily dependent on their American advisers, these troops could not be depended on to fight the insurgents unaided.

In the best of circumstances, says Toby Dodge of the International Institute for Strategic Studies in London, the task of training enough Iraqi troops to withstand the current insurgency would take at least five years, probably longer. “And we're not in the best possible circumstances,” he adds. “We're in the middle of lawlessness and anarchy, trying to build a dam while water crashes in on us from all sides.”

Dr Jaafari's cabinet

A chief strut in this dam, as optimists see it, is Iraq's brand-new and just-formed government. On May 3rd Iraq's first-ever elected prime minister, Ibrahim al-Jaafari, and 29 of his ministers walked one by one to a podium in Baghdad's convention centre and took their oaths of office. Not only violence marred the occasion, however. Several prominent Sunni Arab politicians, including one of two vice-presidents, Ghazi al-Yawar, stayed away, angry that their choices for office had been overruled by the Shia majority. And seven cabinet appointments—including two deputy premierships and the vital defence and oil ministries—remained unfilled, meaning that the squabbling will go on.

As he took office, Dr Jaafari set out to lower expectations. “You all know the heavy legacy inherited by this government,” he said. “We are afflicted by corruption, lack of services, unemployment and mass graves.” To restore services and create jobs, stability is needed, which means that each of Iraq's half-dozen big Shia factions and two Kurdish parties, plus a disorganised Sunni Arab community with few strong leaders, must feel they have a share in government. Handing out ministries as rewards to parties for their good behaviour, however, is a sure-fire way to stoke corruption. Add the historical bitterness between Iraq's ethnic groups, stoked by Mr Hussein's mass killings and by the 1980-88 war with Iran, and finding a solution may well be impossible.

Even the largest factions on Iraq's political scene can claim no more than around one-eighth of the seats in parliament. The two main blocks—the Shia-led United Iraqi Alliance (UIA), which won 140 seats in the 275-strong parliament, and a Kurdish-dominated coalition which won 75—achieved a rough agreement long ago on how to divide the bulk of cabinet posts between them. However, so many horses appear to have been traded in the Kurdish-Shia negotiations, and in disputes within the coalitions, that there may not be enough jobs left over to mollify the Sunnis, who make up the bulk of the insurgency.

Despite their differences, the Kurds (secular and federalist) and the Shia block (dominated by clerics, and centralising) were able to reach agreement to divide the posts roughly in proportion to their strength in parliament. In the final count, the Shias have so far taken 16 cabinet posts, including the premiership, with the Kurds taking nine. In exchange for a commitment to resettle Kurdish refugees in the disputed city of Kirkuk and to accept, at least temporarily, a limited role for Islamic *sharia* in legislation, the Kurds agreed to accept the moderately Islamist Dr Jaafari as prime minister. His two deputies are Rowsch Shaways of the Kurdish Democratic Party (KDP) and the maverick (but secularist) Shia politician, Ahmed Chalabi.

AFP

How much can they do without the Americans?

That, however, was the easy part. The final division of spoils also had to reflect rivalries within the two blocks. Negotiators had to shuffle ministers at the last minute to make sure that neither of the two main Kurdish parties, the Patriotic Union of Kurdistan and the KDP, felt upstaged by the other. Striking a balance between the different factions in the Alliance, who range from secularist independents to followers of the messianic preacher Muqtada al-Sadr, was even more difficult, and was probably the reason why the electricity and oil ministries remain unfilled. For now, the KDP's Mr Shaways will hold

electricity and Mr Chalabi oil.

The two blocks also have to find a role for outsiders, in particular the Sunni Arabs. They agreed to set aside six ministries for Iraq's former ruling minority, but five of those—culture, tourism and archaeology, provincial affairs, human rights, and women's affairs—do not provide the kind of control over jobs, revenue sources and military units that are the main currency in Iraqi political bartering. The Sunnis' sixth ministry, defence, does—but filling that post has proved the biggest hurdle in the forming of the government.

The Shias, especially their most powerful faction, the Supreme Council for Islamic Revolution in Iraq (SCIRI), are insisting that any candidate for the defence job should have no ties to the Baathists. The Sunnis say this is impossible, since almost anyone in public life in Mr Hussein's Iraq, particularly in the army and other Sunni-dominated institutions, had to join the Baath party as a matter of course. They also think a purge foolish, arguing that the new government needs Sunni military veterans in key security posts in order to reach out to insurgents. SCIRI, however, is convinced that members of the security forces with Baathist sympathies are in league with the troublemakers, and it certainly wants them nowhere near government. Its vetting committee has already vetoed several Sunni nominees for the defence job and, for the time being, the post will be held by Dr Jaafari.

Such inflexibility is ominous. Iraq's political factions generally agree—or so the Americans have supposed—that the solution to the insurgency is political. Sunni politicians and Sunni groups, such as the influential Muslim Scholars' Board, would have to be involved in any effort to convince the insurgents to give up their arms. Some Kurds, such as President Jalal Talabani, have made similar noises, calling for an amnesty for guerrillas who are not guilty of acts of terrorism. However, Shia attitudes appear to have been hardened by a series of sectarian massacres, and they now talk of a war to the finish.

The job to be done

Can Dr Jaafari reverse the trend, and bring stability? The signals are mixed. The doctor is regarded as a sincere Islamist who fought for decades against Mr Hussein, but he has a pragmatic streak. He is likely to avoid antagonising the Kurds with overzealous Islamicisation, or riling the Sunnis by settling pre-invasion scores. But he may not be able to keep other members of his coalition in line. Post-war Iraqi politicians have shown an alarming tendency to turn ministries into their personal preserves, packing them with their own supporters and diverting contracts to their allies. If this continues, it could have disastrous effects both on the rebuilding of the Iraqi security forces and on reconstruction.

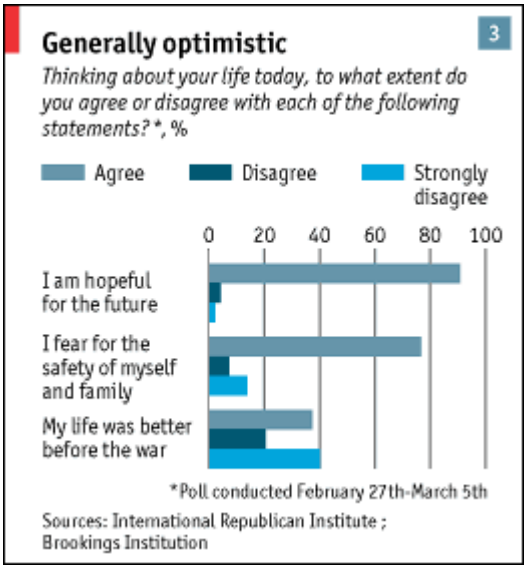
Dr Jaafari and his new team are keen to get public services up to scratch again and rebuild the country's broken infrastructure. There is much to do. Petrol queues stretching for kilometres may almost be a thing of the past, but electricity generation has not improved noticeably since the summer of 2003. Output still falls short of pre-war levels and is just a little over half of demand. Crude-oil production has dipped a bit, to around 2.2m barrels a day (see chart 2): enough to provide an estimated $17 billion in revenues last year, but short of the 2.5m bpd target.

Meanwhile, the economy remains stagnant. Estimates of unemployment, which usually range from 25% to 50%, are almost meaningless, but the overall picture is of only slight improvement since the sanctions-ravaged days before the war. Thanks to reforms brought in during the occupation, civil servants who made a token $2 to $3 a month just before the war now make living wages averaging around $120 a month, and tens of thousands of formerly unemployed Baghdad slum-dwellers are now at work on American-funded infrastructure projects. However, other sectors of society, such as officers in the dissolved pre-war Iraqi army, have seen their living standards decline sharply. No surprise, therefore, that a pool of candidates stands ready and willing to ambush passing marine patrols for a few hundred dollars.

This government's main task, however, is not to sort out the country, but to set up a permanent version of itself. The parliamentary committee charged with drafting the constitution should begin meeting soon, although only optimists expect to see

a draft completed by the initial deadline in August. Parliament will probably seek a six-month extension. The Kurds are insisting that the starting point for negotiations should be the Transitional Administrative Law (TAL), the interim constitution adopted last year by Iraqi politicians under heavy American pressure, which spells out a relatively limited role for Islam in the state and provides for the entrenchment of their northern autonomous zone. Many Shia leaders, however, have already signalled their dissatisfaction with the TAL, claiming that it gives too much power to regional minorities such as the Kurds.

So far, it has taken Iraqi politicians three months to set up even a temporary government. The heart sinks to think how long they may take to reach agreement on a permanent constitution. Meanwhile, at least in the short term, the insurgency seems not dispirited but emboldened by each faltering step towards democracy.


Generally optimistic
3
Thinking about your life today, to what extent do you agree or disagree with each of the following statements? *, %
Agree
Disagree
Strongly disagree
0
20
40
60
80
100
I am hopeful for the future
I fear for the safety of myself and family
My life was better before the war
*Poll conducted February 27th-March 5th
Sources: International Republican Institute ; Brookings Institution

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The Bush presidency

A pretty sticky first 100 days

May 5th 2005 | WASHINGTON, DC
From The Economist print edition

Hardly a triumph. But don't count George Bush out just yet

IT SEEMS to be an iron law of the Bush administration that, whenever the president declares victory, he is soon confronted with disappointment. On May 1st 2003, he landed on the *USS Abraham Lincoln* to declare “mission accomplished” in Iraq. Ever since then, he has been confronted with tenacious resistance. On November 4th last year, he boasted that he had earned “political capital” that he intended to spend on a broad agenda. Ever since then, he has faced frustration.

George Bush was not alone in regarding the November election as a turning point. Tom DeLay, the majority leader in the House, crowed that “the Republican Party is a permanent majority for the future of the country...we are going to be able to lead this country in the direction we've been dreaming of for years.” Mr Bush's margin of victory might have been low by historical standards, but he also—rarely for a re-elected president—saw gains for his own party in both houses of Congress.

This sense that the winds of history had shifted persuaded Mr Bush to launch a strikingly ambitious second-term agenda. It was not enough for him just to consolidate the Bush doctrine in foreign affairs. It was not enough for him to bed down his massive tax cuts (and tend a little more closely to the budget deficit). He wanted to be regarded as a “transformational president” at home as well as abroad—a man who updated the crumbling institutions of Roosevelt's New Deal for the entrepreneurial “ownership society”. The centrepiece would be reforming Social Security.

Yet as Mr Bush reached the first 100 days of his second term last weekend, the talk was not of “transformation” but of frustration—and the possibility of a wasted second term. Rather than comparing him to FDR, pundits now mention the early part of Bill Clinton's first term.

Going backwards?

The evidence of Mr Bush's stalled agenda is everywhere. On Social Security, the latest *Washington Post*/ABC News poll shows support for his handling of reform at just 31%—lower than support for Mr

Clinton's health-care reforms in 1994. He is in danger of losing his nominee as ambassador to the United Nations, John Bolton. Petrol prices are soaring. The economy and the stockmarket are both spluttering. Mr Bush's job-approval rating is hovering at about 47%; only 37% of the population think that the country is heading in the right direction; and support for the Iraq war is at, or close to, its lowest point so far.

Nor is the Republican-dominated Congress proving to be quite the boon that it was supposed to be. Bill Frist, the majority leader in the Senate, who clearly nurses presidential ambitions, is devoting an unusual amount of energy to cultivating the party's conservative base, rather than winning moderate voters to Mr Bush's plans. In the House, Mr Bush has the bigger problem of Mr DeLay. The ethics charges swirling round the majority leader are distracting the party's most powerful legislative organiser, and forcing his colleagues into embarrassing stunts to protect him.

What has gone wrong? Many of Mr Bush's problems can be explained by something that afflicts all second-term presidents—the fracturing of the party after a victorious re-election. But four things have exaggerated this tendency.

First, Dick Cheney has excluded himself from the succession. Normally, the party establishment makes at least a show of lining up behind the vice-president as presumed nominee. This time, Mr Frist and all the other pretenders to the throne in 2008 are freer to define themselves.

The second is the ambition of Mr Bush's agenda. Norman Ornstein of the American Enterprise Institute points out that Mr Bush achieved a huge amount in his first 100 days in 2001, despite barely winning the election. So it was tempting to assume that legislative fireworks might follow the clear victory of 2004.

The third factor is that Mr Bush has shifted the balance of power in his party towards two factions—the religious right and big-government conservatives—and other Republicans don't like it. Mr Bush's decision to intervene in the Schiavo case annoyed both defenders of states' rights and the business lobby, which regarded the battle over the dying brain-damaged woman in Florida as a distraction.

The Republican coalition faces other serious strains ahead. Social Security reform divides anti-tax conservatives, who favour large private accounts, from fiscal conservatives, who are more worried about reducing benefits (Mr Bush seems to be siding with the latter). But this is as nothing compared with the coming battle over immigration. Business conservatives (and Mr Bush) want to make it easier to hire currently illegal people. Yet most of the right's activists are worried about illegals streaming through America's “broken borders”.

The last thing that makes Mr Bush's second term particularly difficult is the united hostility from the Democrats. Most presidents make up for wavering support from their own side by reaching out to moderates from the other party. But Mr Bush infuriated Democrats in his first term by being so partisan himself—campaigning against people who had backed him on important votes. And a growing number of young Democratic activists would rather roast their own grandmothers than compromise with the satanic president.

There is thus a clear possibility of Democrats becoming ever more emboldened by Mr Bush's problems and Republicans becoming ever more divided and demoralised. Yet it would be foolish to exaggerate Mr Bush's problems.

To begin with, Mr Bush's second term has not been bereft of achievements. It started with a notable success in foreign policy—the January elections in Iraq. And there have also been successes at home. To the delight of his business supporters, the administration has passed far-reaching reforms of the bankruptcy system and of class-action lawsuits. Last week the House and Senate also agreed on a budget resolution after two years of impasse.

Next, the Republicans look likely to win at least two of the three battles that are currently roiling Congress—over Mr Bolton, Mr DeLay and Mr Bush's judicial appointments. Mr Bolton looks the most precarious. But Mr DeLay will probably survive as long as no more serious revelations about him appear (see article). As for the judges, Mr Frist seems to have assembled enough votes to carry out his “nuclear threat”—getting rid of the filibuster that allows Democrats to delay judicial appointments. The Democrats have a difficult choice—surrender, or risk losing their ability to filibuster Supreme Court nominees.

Indeed, the Democrats' obstructionism may yet help Mr Bush. So far the public disapproves of most of the things that the Democrats are blocking. But what about the longer term? Even on Social Security, Mr

Bush has jumped the first hurdle—persuading people that the system is in need of change (something that the Democrats still deny). Now that he has embraced the Democratic idea of “progressive indexing” for benefits, it will be harder for his opponents not to engage in negotiations.

The underlying advantage

The problem for the Democrats is that there is probably something to the realignment theory. This doesn't mean that the Republicans can steamroller everything through Congress. But it does mean that the playing field looks favourable: Mr Bush won the popular vote in 255 congressional districts compared with Mr Kerry's 180; there are now as many self-identified Republicans as Democrats; the Republicans have mastered the art of getting out their vote; and so on.

The Republicans enter the next two election cycles with a slight advantage. In 2006, they are likely to hold on to the House (if only because redistricting has rendered so few congressional races competitive) and they may even pick up a Senate seat or two: four of the five Senators who are retiring vote with the Democrats. As for 2008, the Democrats are much more united behind a prospective presidential candidate—Hillary Clinton—than the Republicans are. But many Democrats fear that she is not only too powerful not to be nominated but too polarising to win an election. Recent polls show Mrs Clinton trailing John McCain by seven points in a putative race and Rudy Giuliani by two.

In his first 100 days in office after the traumatic 2000 election, Mr Bush surprised everybody with his determination, pushing through an ambitious agenda while running rings around the Democrats. Things are plainly different this time. Mr Bush has stalled on several fronts—and the Democrats are rediscovering their political skills. But anybody who concludes from this that Mr Bush's second term is already a waste of time is misinterpreting the evidence even more seriously than the Bush team did back in November.

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Tom DeLay's troubles

Local hero

May 5th 2005 | SUGAR LAND
From The Economist print edition

Attack him, and he just gets meaner—and stronger

Get article background

AP

Sweet as sugar, really

HARDLY a day goes by in Washington, DC, without a new ethical problem for the House majority leader, Tom DeLay. Dastardly liberals are running ads against “the Hammer”. Fainthearted Republicans are fretting that what the *Wall Street Journal* calls his “odour issues” are detracting from their agenda.

Sugar Land does not agree. The conservative swathe of Houston suburbia that has sent the former pest-controller to Congress since the 1980s has not lost faith. At a recent meeting of its Rotary Club, all Mr DeLay's difficulties—the ethical rebukes from Congress, the lobbyist-paid trips abroad, the Texas criminal investigation that has ensnared three of his friends—seemed easy to explain.

“Leftist organisations” and “the liberal media” were to blame, Mr DeLay explained—and each time he mentioned these fiends, the well-heeled crowd at the Sweetwater Country Club roared back its support. “Bring ‘em on,” yelled Mr DeLay—a cry taken up again in the parking lot, as the faithful crammed into their Lexuses, Mercedes and four-wheel drives. “We love him just like he was our brother,” explained Billie Neuhaus, a 77-year-old DeLay diehard, as she climbed into her large white car.

It's not that the swirl of controversy around Mr DeLay has not reached Sugar Land. His approval ratings have dipped, and the Washington power-broker has been spending rather more time in Texas than he used to: opening a new office, announcing money for new roads, posing for photographs to celebrate federal funding for new military hardware. There are even a few Democrats who dream of capturing his district, where he won only 55% of the vote last year.

Yet even Mr DeLay's harshest critics find it hard to imagine Sugar Land ousting its hero. A local newspaper publisher, Bev Carter, who is a Republican but, to the Hammer's chagrin, supported his Democratic opponent last year, admits it would take a “perfect storm” to defeat him on his home turf. From the Democrats' perspective, more wrist-slaps from Congress are not enough; Mr DeLay would get into trouble in Sugar Land only if a criminal charge appeared.

The chances of that happening in Texas seem to be receding. Three years into a probe of Texas Republican fundraising, Mr DeLay has yet to receive a subpoena or even officially be told he is under investigation. Texas law helps him. The charges against his friends have been brought in liberal Travis County. Mr DeLay, as congressman for Sugar Land, cannot be indicted there for Election Code violations.

Travis County's Democratic prosecutor, Ronnie Earle, still maintains: “We don't know what the ultimate truth is going to reveal.” But most Texas Democrats now seem to be hoping that something will emerge in Washington.They also worry what Mr DeLay will do to them if he survives. And not without reason. “I tell you what,'' Mr DeLay told the Sugar Land Rotarians. “The more they attack, the stronger I get.”

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The transatlantic relationship

When Javier met Condi

May 5th 2005
From The Economist print edition

Reuters

They agreed to disagree a little more amicably about China

THE course of transatlantic relations seldom runs smoothly. But in recent months the Bush administration feels it has been doing its bit to reach out to its European allies. It has co-operated more closely with Britain, France and Germany over Iran's nuclear challenge, with the European Union as a whole in efforts to restart peace talks between Israelis and Palestinians, and with France in particular over both Lebanon and Sudan. This week it was the Europeans' turn to do some fence mending.

Javier Solana, the EU's high representative for foreign policy, was in Washington, DC, to inaugurate a new “strategic dialogue” on Asia. The Europeans hope this will help save them from Congress's wrath (and retaliation) when they eventually lift their embargo on arms sales to China.

This looks extremely hard. Both the administration and Congress insist the arms ban helps America's strategic interests in Asia. Unlike the Europeans, America has military alliances with both Japan and South Korea. Should push ever come to shove, it is also committed to help Taiwan defend itself from Chinese attack.

The administration is worried that European weapons and civilian technologies with military uses could increasingly help China challenge America at what it is best at: high-tech battle management. One senior administration official stresses that America is not looking for a fight, but if diplomacy were ever to fail it would want any conflict over Taiwan to be over quickly and decisively, with minimal loss of life. Every little edge would count. Japan, China's natural rival for regional influence, has also lobbied unusually hard for the Europeans to keep their weapons ban.

As his grilling at the House international-relations committee showed, Mr Solana's visit to Washington came not a moment too soon. The EU's arms embargo on China was imposed, like America's, in 1989 in protest at the regime's post-Tiananmen clampdown. But France's president, Jacques Chirac, has been campaigning for more than a year for it to go. China is now a very different place, he argues; lumping it together with miscreants such as Myanmar and Zimbabwe is an affront to a country that the EU is keen to count as a new “strategic partner”.

Some Europeans, notably the British, at first resisted. But all eventually agreed last December that the EU's code of conduct on arms transfers would suffice. This frowns on sales of equipment or technology

that might be used to abuse human rights, upset regional balances or harm the interests of allies. The separate embargo on China seemed set to go early this year.

A furious transatlantic row erupted. Congress passed resolutions that threatened to disrupt defence co-operation with European companies that sell equipment to China. Opposition to Europe on this issue stretches from left-leaning Democrats to right-wing Republicans, and from the human-rights lobby (many Tiananmen activists still languish in China's jails) to security hawks.

Forced to take notice, the Europeans now say their plan to lift the embargo still stands, but with no firm date. China inadvertently helped the EU save face by passing an anti-secession law in March that formally threatened the use of force, should Taiwan declare itself independent.

This week, Mr Solana, who as a former NATO secretary-general is seen in Washington as one of the less wimpish Europeans, maintained that Europe has learnt its lesson. Until now the EU, with no security commitments in Asia, saw no reason not to put its commercial interests there first. That was dangerously short-sighted, given that Europe's massive trade and investment in the region depends on the stability that American forces provide. Mr Solana spent much of this week trying to convince official America that the Europeans in future would have America's security concerns in Asia at heart.

To this end, his officials explained that the Europeans have updated and tightened regulations first adopted in 2000 on the transfer of dual-use equipment and technology. They are considering giving more force to their code of conduct on arms sales (which is politically rather than legally binding), by making it formally a “common position” of the EU. They have also agreed to more frequent monitoring of licences issued or denied for arms and technology sales to China (90% of those currently denied already fall under the code of conduct, rather than the separate arms embargo, they say).

However, the fact remains that Europe is still committed to removing the embargo. These days it is Japan, more than Europe, says one senior administration official, that can “finish our sentences” on issues like export controls and regional security. Even some avowedly Atlanticist officials in Washington are starting to wonder whether the EU, consumed by its ever more complex internal affairs and seemingly oblivious to problems farther away, will ever live up to its promises to contribute more to security in the wider world.

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Foreign languages and security

Know thine enemy

May 5th 2005 | NEW YORK
From The Economist print edition

America is still struggling to address its shortage of Arabic linguists

NEARLY 50 years ago, the Soviet Union launched a tiny beeping ball into orbit around Earth. Though Sputnik posed no direct threat, it terrified America into pouring money into learning about Russia—and teaching its history, culture and language to several generations of diplomats, soldiers and spies. In 2001, 19 Arabic-speaking young men killed thousands of Americans (and people from other countries) with a low-tech hijack of four aircraft. Yet more than three years later, America is woefully short of the linguists and "area experts" that it needs.

AP

The front line in the war on terror

The various inquiries into September 11th are full of worrying statistics. The army had filled only half its authorised positions for Arabic translators; a shortage of translators at the FBI meant that thousands of hours of audiotape had gone untranslated; the CIA had not been through countless technical papers about foreign countries' scientific research; and, of course, the spying agencies were woefully short of Arabic- and Farsi-speaking agents.

Progress since then has been slow. For instance, the Pentagon released its "road map" for meeting its deficiencies only this January. Its assessment is frank ("Language skill and regional expertise have not been regarded as warfighting skills") and it recommends sensible changes, such as requiring junior officers to have language training. But it does not know how many linguists it has or needs.

The Pentagon's sluggishness is all the more remarkable in the light of Iraq. Some brigades there have only one fluent Arabic-speaker. There are said to be just 1,850 known Arabic-speakers in the army (though that figure may grow when the Pentagon finally finishes its audit). By and large, the demand in Iraq has been filled by locals of variable quality—and loyalty.

Demand outstrips supply in the spy services as well. The CIA's need for Arabic speakers roughly quintupled after September 11th, though exact figures are classified. Porter Goss, the agency's director, wants to increase the number of his spies and analysts by 50%. But it takes years to train a man or woman in language and tradecraft. Mr Goss has also admitted that "the great bulk of what we need is more than five years out there."

To be fair, there are reasons why Islamic terrorism is proving harder to cope with than the Russian bear. The cold war presented America with one main enemy and one crucial language, which happened to be a European one with some similarities to English. Al-Qaeda's recruits hail from dozens of countries,

stretching from Morocco to Indonesia; they speak far more languages (Pushtu, Farsi, Uzbek and Urdu, for instance); and those tongues are not easy for westerners to learn.

Even if you focus on Arabic, it takes more than a year of full-time training to get a new student to level two on the government's five-point scale. And Arabic comes in a frustrating array of dialects. Most Americans learn formal Arabic, but the Egyptian dialect is as different from the Moroccan as French is from Spanish.

Inevitably, both the Pentagon and the intelligence services have turned to recent immigrants. “Heritage” speakers—American citizens who can still speak their native languages and understand the culture—are offered signing bonuses of up to $3,000 by the army. A recruit can also earn an extra $1,000 a month if he speaks a particularly important language. The FBI and CIA offer similar incentives.

But recruitment is difficult. The FBI will not take dual citizens. Background checks can stretch to six months, especially if an applicant has lived abroad. To make matters worse, many Muslim Americans are critical of the war in Iraq, America's support for Israel and a perceived crackdown on civil liberties at home.

Congress has given more money for foreign-language training. Funding for such programmes rose by about 65% in 2001-04. But it has come in a piecemeal way. In the last Congress, Rush Holt, a New Jersey congressman, tried to push through a more comprehensive bill which would make money available to recruit more heritage speakers and also forgive the college loans of some “critical language” speakers who take government jobs. Now he is trying again and plans to attach his bill to a larger defence or education package.

One glimmer of hope is the fact that things are looking up a little in universities. The most recent study by the Modern Language Association, which admittedly covers only the school year that began in 2002, shows that enrolments in Arabic and Farsi had both doubled by then from 1998 levels, to 11,000 and 1,100 respectively. Other languages also grew, albeit from feeble amounts: Pushtu rose from no students in 1998 to 14 in 2002; Uzbek from four to 23 students. Most of these people intend to work for the government in some form.

Anecdotal evidence suggests that this collection of potential future spies and translators has grown again since 2002, perhaps by as much as a quarter. But it is plainly a puddle of talent, rather than a pool. At the end of the cold war, in 1990, some 45,000 students were learning Russian; there were still some 24,000 in 2002. For the immediate future, America is still trying to fight a war conducted in languages it does not understand.

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About sponsorship

North Dakota

A plug for the Plains drain?

May 5th 2005 | FARGO
From The Economist print edition

Young families may help the cities and suburbs—but not the farms

HAVING survived the winter, North Dakota's stouter residents feel they may as well stick it out, at least till the end of summer. But many younger folk have already left. Cold is one of several reasons why the state has a “brain drain” problem.

Virtually all the state's counties have been losing well-educated young people to other states. Only Iowa retains fewer of its young home-grown college-educated residents. And, as with Iowa, lack of good jobs is another crucial factor. With farm jobs slipping away, North Dakota has struggled to find new ones in services.

But North Dakota's brain-drain problem is also, paradoxically, a symptom of its success in educating its residents. It has the second-highest high-school graduation rate in the country, and ranks first in the number of students who continue on to college. The trouble is that they don't stay: the state ranks 22nd in the proportion of residents over 25 with a college degree.

This may be changing, gradually. Census estimates for 2004 show that the state's population grew for the first time since 1996, albeit by barely 1,000 people, to 634,000. Births outnumbered deaths, and the number of college graduates staying in the state for at least a year after graduation rose 3.5% to 57%. Chuck in rising elementary- and secondary-school enrolment, and a new theory is emerging: young families are returning to North Dakota, particularly to its bigger towns and suburbs.

The main beneficiary is Fargo, North Dakota's largest city, which grew by more than 20% in the 1990s. Microsoft, which bought a local company in 2000, now employs 1,000 people there. The city is spreading outward into the Plains, and its downtown boasts an increasing number of chic restaurants, including one based vaguely on Berkeley's Chez Panisse.

In short, though very white and staid, Fargo seems to be just interesting enough to lure back young professionals. Tamra McCullough left North Dakota for Seattle in 1995 and got a job at Starbucks Coffee's headquarters. In 2002 she returned to Fargo with a husband and a son. She was afraid they would get bored, but they didn't. She encouraged Starbucks to open a shop in Fargo last June.

Starbucks may hardly be the apex of hipness. But Joel Kotkin, a Los Angeles-based demographer, points out that good coffee is now part of the list of assets that North Dakota offers refugees from California and New York. The state's longer-established temptations are its schools and its clean air, plus the second-lowest average commute time in the nation and the lowest median house price.

None of this, of course, helps rural North Dakota, and many small farming towns are dying. This has led some locals to consider a modern version of an old idea, the Homestead Act of 1862, which helped to populate the Plains by giving settlers up to 640 acres of land in exchange for a commitment to stay for five years.

One of those lured by this bribe was the great-grandmother of Byron Dorgan, the state's Democratic senator. Mr Dorgan is the chief author of the New Homestead Act, which would provide a host of incentives to people who settle in counties that have lost more than 10% of their population in the past 20 years. These include tax credits for starting small businesses and buying homes, and a $3 billion venture-capital fund to seed new businesses.

Mr Dorgan has introduced the bill into the Senate twice already, in 2001 and 2003, with no success. Undeterred, he introduced a new version last month. “We may discover that [the demise of the Plains]

was inevitable and there's nothing we can do about it," he admits. "But it won't be for lack of trying."

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The decline of Texas

Has it come to this?

May 5th 2005 | AUSTIN
From The Economist print edition

Cheerleading is in trouble in the state where it became an art

Get article background

WHAT on earth is happening to Texas? This week, politicians in the home state of both the Dallas Cowboys' cheerleaders and the “pom-pom mom” (who was convicted of plotting to kill the mother of her daughter's cheerleading rival), decided a gal could gyrate too far. On May 3rd, the state's House of Representatives voted to crack down on “overtly sexually suggestive” routines.

The bill was actually sponsored by a Democrat, Al Edwards, who is an ordained minister, but it won fairly solid conservative support. “There is a lack of old fashioned morality, the morality you and I grew up with,” lamented one Republican state representative, Carl Isett. “If I take my five-year-old son to a high-school football game, I don't want to cover his eyes when the cheerleaders are on the field.”

Isett junior, whose views on this matter may differ from his father's, should be saved from this threat if the bill clears the Senate and is signed into law by Governor Rick Perry (as is likely). The bill would require school districts to take “appropriate action” against offensive acts at school events as identified by state education authorities. Districts would have to appoint cheerocrats—plainly a demanding and thankless job—to identify the culprits.

Critics call the bill unenforceable and unconstitutional. “Why not go all the way?” asks the American Civil Liberties Union's man in Texas: “Why not require them all to wear a *burka*?” Others point out that it is hard to define what is sexual. “When I was 15, anything a cheerleader did was interesting to me,” observed Rene Oliveira, a Democrat who opposed the bill. But the Reverend Edwards was ready for that one: “Any adult that's been involved with sex in their lives, they know it when they see it,” he said knowingly.

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Lexington

Crisis? What crisis?

May 5th 2005
From The Economist print edition

Prophets of doom are appearing on both sides of the political divide. Ignore them

AMERICA'S liberal and conservative elites disagree about everything under the sun, from the role of God in the constitution to John Bolton's table manners. Yet on one issue they are as one: the country is going to hell in a hand-basket.

For liberals, Americans are suffering from epidemics of “traumas” and “syndromes”. The left has always worried about the effects of rapacious capitalism on the American psyche. Listen to Mary Pipher, a bestselling clinical psychologist, on girls: “Just as planes and ships disappear mysteriously into the Bermuda Triangle, so do the selves of girls go down in droves. They crash and burn.” Or compare William Pollak, a Harvard psychologist, on boys: “Our nation is home to millions of boys who...are cast out to sea in separate lifeboats, and feel that they are drowning in isolation, depression, loneliness and despair.” Half an hour listening to “Oprah” or browsing in a bookshop could produce a dozen equally depressing theses, expressed in equally dismal metaphors, about every sort of American.

This literature is built on one huge assumption: that Americans are a fragile bunch. Forget about the flinty Pilgrims who built a hyperpower out of a wilderness. Today's Americans are so vulnerable they need to be shielded from competition. In their excellent new book, “One Nation Under Therapy: How the Helping Culture is Eroding Self-Reliance” (St Martin's Press), Christina Hoff Sommers and Sally Satel, of the American Enterprise Institute, detail the rise of an ever-proliferating profession of grief counsellors, trauma therapists, syndrome specialists, stress-reducers and assorted degree-bearing charlatans.

This book has naturally garnered favourable reviews from fellow conservatives. Yet the right is equally prey to its own variety of crisis-mongering. Conservatives blame sin, rather than syndromes, and cultural decline, rather than economic dislocation. But many share the left's sense of human vulnerability, and a surprising number have a weakness for psychobabble. It is no accident that the most powerful man in the Christian right, James Dobson, the head of Focus on the Family, is both a child psychologist and a veritable fountain of social-science statistics.

For conservatives, the family is being battered by pop culture, gay rights and feminism. Rebecca Hagelin of the Heritage Foundation argues that, thanks in part to the ubiquity of the porn culture, America has gone “stark raving mad” (to use the subtitle of her new book). Gloomy conservative groups issue toe-curling warnings about the “inexorable grip of homosexual lust” and “feminism's love affair with abortion and lesbianism”.

Is this really true? Take a look at most of the recent cultural indicators, and it is hard to know where to start with the good news. The proportion of black children living with married parents is increasing. The proportion of women with infants in the workforce (the women that is, not the infants) is declining, meaning that more mothers are staying at home. Both teenage pregnancy rates and teenage abortion rates have declined by about a third over the past 15 years. For all the talk of “hooking up”, a growing proportion of schoolchildren are waiting to have sex until they are older.

The good news is not confined to sex. Child poverty is down substantially from its high in 1993 (whatever happened to the “disastrous consequences” of welfare reform?). So is juvenile crime. Alcohol and drug use are lower. The idea that young America is tossing about on a sea of misery hardly tallies with academic evidence, which shows 73% of teenagers to be “hopeful and optimistic in thinking about the future” (a Horatio Alger study in 2002-03), a mere 7.5% of college students feeling frequently depressed (UCLA, 2003) and the teen-suicide rate down by a quarter (the Centres for Disease Control, 2004).

Always look on the bright side of life

This is not to argue that America is a perfect place, just that the recent statistical evidence is mixed. Sadly such nuances (and respect for data) are lost in political debate. Worried about the homosexual agenda, conservatives in the Texas House of Representatives recently passed a child-services bill with an amendment that would ban same-sex couples from becoming foster-parents. This was based on a worrying but bogus “statistic” that the children of same-sex parents are 11 times more likely to be abused than the children of heterosexual parents. In Alabama, Gerald Allen, a state legislator, recently sponsored a law to prevent state funds from being spent on books that are written by gay authors or that feature gay characters. “Dig a hole, and dump them in it” is his solution for much of English literature.

Southern theocrats tend to get the headlines; but, in truth, they are less influential than the therapists, particularly in schools. Anything that even sniffs of creationism will get a school district into the *New York Times* overnight; but it is now perfectly normal to phase out competitive sports to spare children the trauma of losing, or to ban games of tag because the child who is chosen to be “it” may suffer from “self-esteem issues”. Ms Sommers and Ms Satel point to the growing fashion for games in which children compete only with themselves (such as juggling, unicycling or “manipulating wheelchairs”). But even juggling comes with a health warning: use silk scarves (which are “soft, non-threatening and float down slowly”) rather than unco-operative tennis balls.

The result is a paradox. Left to their own devices, Americans are clearly capable of repairing their family lives even in the face of severe social dislocations. But this natural psychological buoyancy is being threatened by various crisis-mongers from both the left and the right. In 1945 Clement Attlee, then Britain's prime minister, wrote to Harold Laski, a voluble left-wing intellectual, suggesting that “a period of silence would be welcome”. The same can be said of America's crisis-mongers.

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Canada

Harper's high-wire act

May 5th 2005 | OTTAWA
From The Economist print edition

The Conservative leader prepares to try to oust Paul Martin, a prime minister who is down but not quite out

Get article background

A COUPLE of weeks ago, Canada's Conservatives seemed to see the road to power open up before them after a dozen divided and difficult years in the wilderness. Public support for the Liberal minority government plunged after a judicial inquiry heard damaging testimony of sleaze and party kickbacks. An opinion poll put the Tories ahead by as much as 11 percentage points. It seemed only a matter of time before Stephen Harper, the Tory leader, would join forces with other parties in Parliament to bring down the government and run the Liberals out of office at Canada's second election in a year.

It could still happen. On May 2nd, the Conservative parliamentary caucus backed Mr Harper's decision to table a motion of no-confidence in the government at the first available opportunity. But even if this succeeds—the arithmetic is complex—the polls now suggest that the Conservatives cannot be sure of forming a government after an election. Rarely has Canadian public opinion been so volatile.

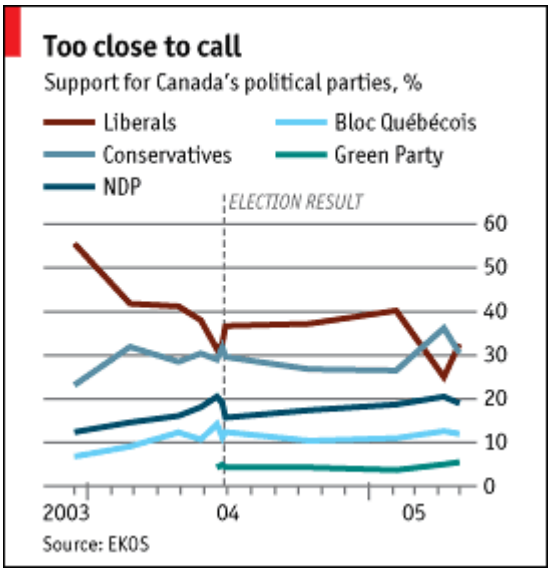
Paul Martin, the embattled prime minister, has done his best to outwit Mr Harper. Last month he commandeered the airwaves to address the nation—something Canadian leaders rarely do. He apologised for party corruption. He vigorously denied any personal involvement in the matters under investigation by Judge John Gomery's inquiry: rake-offs from a government scheme to promote federalism by sponsoring sporting and cultural events in French-speaking Quebec. This scheme operated when Jean Chrétien was prime minister (and Mr Martin his finance minister). He claimed that a snap election would pre-empt the inquiry. Instead, he pledged to dissolve Parliament within 30 days of Judge Gomery's report, due in December.

The prime minister's next step was to shore up his parliamentary support by cutting a deal with the leftish New Democratic Party (NDP). This involved rewriting parts of the budget. Mr Martin withdrew promised tax cuts for businesses and added C$4.6 billion ($3.7 billion) in spending on low-cost housing, the environment, education and foreign aid.

The government can afford this largesse: the Liberals have delivered a budget surplus for the past eight years. But business lobbies were furious. Rolling back the tax cuts “sends a message...that Canada is losing interest in competing for investment and jobs,” fumed the Canadian Council of Chief Executives.

For now, the audiences that matter to Mr Martin are the House of Commons and public opinion. In both arenas, his prospects look a little less bleak. Not that the deal with the NDP guarantees the government's survival: combined, the two parties have only 151 of the house's 308 seats. The Conservatives with 99 have the backing of the 54 MPs of the separatist Bloc Québécois. So any confidence vote would turn on the votes of three independents, one of whom has said he will back the government. To complicate matters, three MPs are seriously ill. The Liberals are using an obscure parliamentary procedure to delay a confidence vote. They cannot indefinitely prevent one. But would Mr Harper win an election were one to follow?

The Tories are already trotting out star candidates they have recruited and sharpening their attack ads. Mr Harper's calculation is clearly that he must strike while public anger over Liberal sleaze is at its peak, or risk missing his chance. This looks like a gamble. A crop of recent opinion polls suggested that the Liberals have regained a narrow lead over the Conservatives. But in suburban Ontario, where Canadian elections tend to be decided, that lead is stronger. That may be why Belinda Stronach, a leading Tory moderate from Toronto, expressed doubts over the wisdom of an early vote.



Why is public opinion so ambivalent? Polls suggest many voters are not keen on another election so soon, though those reservations might dissipate once a campaign began. In English-speaking Canada, Mr Harper may receive few thanks for helping the Bloc, which is set to be the main beneficiary of Quebec's disgust over the sponsorship scam.

Almost all Canadians seem eager to punish the Liberals for steering hundreds of millions of dollars of public money to party friends. But far fewer want to give power to Mr Harper, a man many do not trust fully or feel much warmth for. He has made efforts to move his party towards the centre. Abortion rights, bilingualism, the Kyoto protocol on greenhouse-gas emission and state-financed health care all found support at the party's recent policy convention. But Mr Harper, who made his political career in Alberta, Canada's most Americanised province, is still seen by many as an icy neo-conservative more in the mould of America's Republican Party than of consensual Canada. The next few weeks will make or break Mr Harper's career. He will either become prime minister, or be cast on to Canada's large scrap heap of failed conservative leaders.

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Mexico

The race is on

May 5th 2005 | MEXICO CITY
From The Economist print edition

Voters will now have to judge Mr López Obrador as a candidate, not a martyr

Reuters

Foxy López Obrador and many friends

AN ANCIENT Greek saying has it that the fox knows many small things, while the hedgehog knows but one big thing. In Mexican politics, however, it is President Vicente Fox who looks like the hedgehog. His contention that it was time for a change after seven decades of one-party rule took him to a historic election victory in 2000. Since then, he has shown little grasp of the many small things required for a successful presidency. That lack of subtlety showed in a blunt and controversial effort to block Andrés Manuel López Obrador, the leftist mayor of Mexico City, from running in next year's presidential election through a prosecution widely seen as politically motivated.

On May 4th, Mr Fox finally abandoned that effort. His new attorney-general, Daniel Cabeza de Vaca, announced that the charges against Mr López Obrador, which arise from a planning dispute, would be dropped, allowing him to run for the presidency. Mr Fox and the mayor are to meet, presumably to bury the dispute.

For Mr López Obrador, a politician of fox-like cunning, this is an extraordinary victory. Without any sweeping political platform, he has become the favourite to win next year's election. His popularity originated from his populist rhetoric, social programmes and knack of setting the political agenda. But it would not have reached its current heights without the judicial campaign against him. A poll by *Reforma*, a newspaper, in early May gave him an 84% approval rating.

Mr Fox's climbdown began after a “silent march” of some 1m Mexicans in support of Mr López Obrador on April 24th. Three days later the president fired his attorney-general, who had brought the charges, and promised a review of the case. It is not the first time that Mr Fox has backed down in the face of opposition. Some say his presidency has never really recovered from a decision to cancel a planned new airport for Mexico City when local farmers staged protests. What makes the latest about-face so embarrassing is that Mr Fox and his officials have insisted that the issue at stake in the mayor's prosecution is one of principle: the rule of law and the notion that nobody is above it.

The charges, which the mayor denies, stem from the city government's failure in 2001 to obey a court order to halt construction of an access road to a private hospital. Mr Cabeza de Vaca said that the mayor's actions may have been unlawful but did not merit a penal sanction. Indeed so. But given the government's previous insistence on criminal charges, it now looks as if the law is being stretched to suit an individual—precisely what Mr Fox had earlier said he could not contemplate.

It could be argued that at least the president acted swiftly to cut his losses once he saw the strength of public support for the mayor. Santiago Creel, the interior minister and a likely presidential candidate for Mr Fox's conservative National Action Party, said that he had always expected Mr López Obrador to be a candidate in 2006. The president's volte-face may have done more damage to Roberto Madrazo, the probable candidate of the formerly ruling Institutional Revolutionary Party. Mr Madrazo had backed last month's vote in Congress to lift the mayor's immunity from prosecution. He was left complaining that Mr Fox was meddling in politics.

For now, Mr López Obrador looks unstoppable. But the election is still 14 months away. The mayor can no longer reap easy popularity by presenting himself as a martyr. He will have to campaign on a positive platform, rather than against persecution. The election campaign has begun, but it is far from over.

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The Organisation of American States

Leading from the south

May 5th 2005 | SANTIAGO
From The Economist print edition

Right man, tough job

THE United States, Winston Churchill noted, can always be relied upon to do the right thing—once it has exhausted all the alternatives. So it proved last week, albeit in a matter of less moment than Churchill had in mind: finding a new secretary-general for the Organisation of American States (OAS). Having tried fruitlessly to secure the election of two other candidates, the Americans finally threw their weight behind José Miguel Insulza, Chile's interior minister. On May 2nd, he was elected with the support of 31 of the OAS's 34 member states.

Mr Insulza is an experienced and pragmatic politician. He was always the best candidate. An opponent of the 1973-90 dictatorship of General Augusto Pinochet, he nonetheless led the efforts as Chile's foreign minister to bring the general home after his arrest in London in 1998. As interior minister in President Ricardo Lagos's government since 2000, he negotiated agreements with the right-wing opposition, including one to abolish authoritarian vestiges in Chile's constitution.

Mr Insulza would have won anyway. But it would have been a narrow and divisive victory over Mexico's foreign minister, Luis Ernesto Derbez, with whom he had tied in voting last month. The United States backed Mr Derbez after its original candidate, a former president of El Salvador, failed to gather support. Mr Insulza had the support of South America's centre-left governments, including Brazil's. But he also had the backing of Venezuela's anti-American president, Hugo Chávez. That put the United States off.

The breakthrough came when Mr Derbez agreed to stand down during a visit to Santiago last week by Condoleezza Rice, the American secretary of state. She met Mr Insulza for the first time. Chilean officials told her that they had made no promises in return for Mr Chávez's backing and his help in gathering support among Caribbean countries, whose economies depend on subsidised Venezuelan oil. According to Heraldo Muñoz, Chile's ambassador to the United Nations, Ms Rice was told that “Chile has a policy on democracy and human rights that it doesn't change for votes.”

The OAS has long been regarded as both the plaything of the United States, which puts up most of the money, and as a convenient place to park Latin America's more intractable problems. But in 2001, its members adopted a charter that obliges them to uphold democracy or risk sanctions. The United States would like to apply this to Mr Chávez, but South America is wary. Mr Insulza may take a robust view of the issue. “Elected governments that do not govern democratically should be held accountable to the OAS,” he says.

Some saw the hand of Roger Noriega, America's senior State Department official for Latin America, in the ill-starred attempt to block Mr Insulza. If so, Ms Rice appears to have taken a more strategic view. Mr Insulza is a socialist, but he is a pro-market moderate. He comes from a country which many see as a good advertisement for liberal economic reform, and with which the United States has good relations. And any attempt by the superpower to isolate Mr Chávez is bound to fail unless it has the support of the centre-left governments of Brazil, Argentina and Chile.

Mr Insulza will have other headaches. Bolivia (along with Mexico) abstained and Peru cast a blank vote because their peoples still lament Chilean annexation of part of their territory in a 19th-century war (see article). But Mr Insulza's term is sure to be dominated by Venezuela. It will be a help that he cannot be portrayed as a puppet of Washington. That doesn't make a thankless task much easier.

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Ecuador

After the Palacio coup

May 5th 2005 | QUITO
From The Economist print edition

Now let's spend

Get article background

HIS legitimacy is debatable, and his welcome may prove short-lived. But for now at least, Alfredo Palacio, Ecuador's new president, has gained the grudging acceptance of both the outside world and his own country. He seems intent on making the most of this by diverting his country's burgeoning oil revenues to social expenditure, at the expense of debt repayment.

Mr Palacio owes his new job to last month's week of protests in Quito, the country's capital, after which 60 of the intrigue-riven Congress's 100 members voted to replace the elected president, Lucio Gutiérrez, with Mr Palacio, his vice-president. Mr Gutiérrez had caused anger by dissolving the Supreme Court, but the manner of his ousting stank of a coup. The legislators held their session not in Congress but in a college, with none of the president's supporters present. Mr Palacio and his backers had to flee an unruly mob.

Brushing off calls for a new election—from Brazil and the United States, as well as from demonstrators at home—Mr Palacio says he will serve out Mr Gutiérrez's term, which ends in January 2007. He has promised to reform the courts, and hold a referendum on reforming a dysfunctional political system.

The new president's backers are a heterogeneous coalition of the conservative Social Christians, the Democratic Left and Pachakutik, a left-wing Andean-Indian party. Last week this coalition increased its majority by suspending nine congressmen who had switched parties and replacing them with loyal alternates. Although it went on to approve rules for selecting a new Supreme Court, it will find it hard to persuade Ecuadoreans that the new court will be any more independent than its predecessors. Mr Palacio said he might veto part of this bill. But Congress is the real power in Ecuador, at least when it has a functioning majority. And many of those in Mr Palacio's cabinet have ties to the three dominant parties.

Mr Palacio's economy minister is Rafael Correa, a left-wing academic who opposed the decision in 2000 to make the dollar Ecuador's currency, and whose appointment spooked the financial markets. Mr Correa quickly said that abandoning the dollar now would be “suicide”. All the same, the economic outlook is uncertain. Twice in the past quarter-century Ecuador has defaulted on its debts. For all his faults, Mr Gutiérrez had brought a new seriousness to the public finances, adhering to a law requiring part of any oil windfall to be used to repay debt. Mr Correa intends instead to increase social spending. That—and the new government's hesitancy about free trade with the United States—may hold the street at bay for a while.

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Peru and Chile

Refighting a war

May 5th 2005 | LIMA
From The Economist print edition

Injuries, real and imagined

Get article background

ALONG with colonial churches and mansions and pleasant parks and beaches, Lima has much urban squalor. It is, after all, the capital of a fairly poor country. But understandably enough, Peruvians were not amused when LAN-Peru, the country's biggest airline, recently aired an in-flight video made in 1997 promoting “adventure tourism”. This showed filthy streets and ragged homeless people urinating in them. LAN's parent company is Chilean. The affair injected new heat into Peruvians' traditional animosity towards their southern neighbours.

The airline apologised and fired the managers responsible. That did not deter Peru's Congress from taking a hand. A congressional committee changed a transport bill to ban investments in ports and airports from “neighbouring countries with a Pacific coastline”. President Alejandro Toledo's government called off a bilateral meeting of foreign and defence ministers, and backed away from plans for free-trade talks with Chile.

Officials also chose to rake up allegations by an Ecuadorean general that Chile had sold his country weapons during a border war with Peru in 1995. Chile responded that the sale was in 1994; the general later admitted he got his dates wrong. Even so, Peru wants a formal apology.

Chilean politicians dismiss all this as an attempt by Peru's unpopular president to distract attention from his woes. They note that Peru protested less vehemently when Argentina, its alleged ally, sold arms to Ecuador during the war. In 2003 the authorities shut down a Chilean-owned pasta factory built illegally in wetlands near Lima, but they have done nothing about two nearby American-owned factories. Similarly, two Chilean youths who sprayed graffiti on an Inca wall in Cusco spent six months in jail, whereas a Peruvian beer company which damaged Machu Picchu's stone sundial while filming a commercial got away with a small fine.

Chile's firms have invested in prominent businesses in Peru: department stores and petrol stations as well as the airline. To Peruvians, that rubs in their relative poverty. They cannot forget that much of Chile's mineral wealth comes from land that once belonged to them or to Bolivia, seized in the war of 1879-83. Chileans could show more sensitivity to this. But rather than gripe, Peruvians would do better to try to emulate Chile's success.

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Baluchistan

The tribes arise

May 5th 2005 | DERA BUGTI
From The Economist print edition

Can Pakistan tame the restive province?

Get article background

IN THE Hindu ghetto, a maze of winding alleys and bright-coloured temples, Lal Chand sluices water over the dried blood and innards of his neighbour. Of 67 people killed in a battle in March between tribal militiamen and government troops in Dera Bugti, a small town in Pakistan's western province of Baluchistan, around half perished when the ghetto was shelled by the government's men. Their target was a large white house adjoining the ghetto's walls: the ancestral home of Nawab Akbar Khan Bugti, septuagenarian *sardar* (tribal lord) of the surrounding 5,000 square miles (13,000 sq km) and their 150,000-odd residents—and thorn in the flesh of Pakistani governments for half a century.

But the government failed to kill Mr Bugti in the fray—which, it claims, began when his bearded tribesmen attacked its troops outside the town. Nor did its violence end a decades-old dispute with the wily and charismatic *sardar* over the sharing of revenues from local gasfields, or ease tensions across Baluchistan, a vast and increasingly violent land.

All the same, in the contradictory way of Pakistani politics, the government in Islamabad may after decades of occasionally brutal rule over the provinces be about to adopt more moderate policies. On May 3rd, a parliamentary committee headed by Chaudhry Shujaat Hussain, the leader of President Pervez Musharraf's ruling Pakistan Muslim League, issued 32 recommendations on how the government should address grievances in Baluchistan.

It is Pakistan's poorest province. The committee's recommendations include giving Baluchistan's inhabitants a bigger share of gas revenues and more jobs in gas exploitation. The committee wants the government to pay the province arrears, estimated at 6 billion rupees ($100m), and to give Baluchis a far bigger part in the building of a new deep-water port on the province's coastline, at Gwadar. These recommendations, if adopted (for it is by no means certain they will be adopted) would signal a big concession from Pakistan's central powers, dominated by a mostly Punjabi military elite, to the country's unhappy margins. They would also be long strides towards ending a conflict that has recently started to cause serious unease around the region.

The people of Baluchistan have good reason to resent their government—or “Pakistan” as they sneeringly refer to it, as if to a foreign country. Eight out of ten lack safe drinking water and nine out of ten have no gas. This last rankles especially, given that Baluchistan produces most of Pakistan's gas, including about 1 billion cubic feet (28m cubic metres) per day—roughly 45% of total production—from a single gasfield at Sui, on Mr Bugti's estate. The neighbouring fief of Nawab Khair Bakhsh Marri, the most belligerent of Baluchistan's *sardars*, contains oil and coal, but the government has not dared to exploit it.

In a province flush with guns—and ruled by them in its most tribal parts—insurgency has flickered in almost every decade of Pakistan's existence. In the mid-1970s the government sent 80,000 troops to crush an uprising of Marri tribesmen and Marxist guerrillas, with great bloodshed on both sides. In each of the last two years, around 100 policemen, soldiers and civilian officials have been murdered, and pipelines and railways blown up. In January, the Sui gasfield was closed after an attack by gunmen. A little-known group, dominated by Marri tribesmen and calling itself the Baluchistan Liberation Army (BLA), has often claimed responsibility for these actions. Perusal of the province's newspapers suggests that most districts of Baluchistan see an insurgent attack every few days.

The foreign hand

Unwittingly, outsiders have stoked the conflict. Thirsting for oil, America and India want to build a pipeline through the province, running south from the wells of Central Asia, or, in India's case, east from Iran. India's dynamic oil minister, Mani Shankar Aiyar—who also dreams of a pan-Asian gas grid—has suggested that the second pipeline could be completed by 2011. On reaching the coast, the Central Asian pipeline would disgorge into supertankers gathered off the emerging port at Gwadar. Chinese engineers are building the port with an initial loan from China of $200m. As its capacity increases, Gwadar will halve the distance between Xinjiang, the westernmost province of China, and its nearest accessible port—currently some 2,000 miles (3,000 km).

Baluchi nationalists, and especially the BLA, take particular exception to the emerging port. Last May, three Chinese engineers were killed and 11 injured in Gwadar by a car bomb. The nationalists consider it another avenue for the government to plunder their resources. But more important, with an eye on the teeming slums of nearby Karachi, they fear it may draw in millions of outsiders, making the Baluchis a minority in their own land.

Under the current system, this increased population would at least give the province a bigger slice of the national pie: 37% of the budget is divided among Pakistan's provinces on the basis of population size, with Punjab taking over half the total, and Baluchistan's current population of 6.5m a mere 5%. Mr Hussain's parliamentary committee recommends distributing such revenues according to need, with the most backward areas receiving most money. It also proposes a raft of measures to make the Gwadar development more palatable to locals: a majority of jobs in its construction would be reserved for them and special scholarships awarded to their children. Yet even all this may not placate the nationalists whose real fear is of becoming an ethnic minority and so losing their influence at the polls.

Conspiracy unlimited

Where the pipelines are concerned, the nationalists appear to be gripped by a common delusion that

America secretly wants Baluchistan to secede from Pakistan, in order to secure the superpower a new source of oil. Indeed, the uniformity of the nationalists' expressed grievances and conspiracy theories, is striking. Traditionally, the government found it easy to use patronage to divide the warring tribes. Of late, however, a greater coherence has emerged. Last year, the four Baluchi nationalist parties, including three headed by *sardars*, formed an alliance to put their demands to the parliamentary commission. Also last year, the Bugti and the Marri ended a 50-year feud. No Baluch nationalist seems to condemn the BLA's murderous campaign. In his handsome Karachi home, Ataullah Mengal, the third senior *sardar*—and another grand old man—says: “The armed struggle has begun, the Chinese engineers have been killed, bomb-blasts are going off every day. The cost will be dear, but we are asking for something dear and for that we must pay dearly, even with our lives.”

Another novelty in the nationalists' campaign is the part played by Mr Bugti, in his blood-splattered town. A former minister of interior and of defence, Mr Bugti is no separatist. He has long sparred with successive governments for money and political influence, and has spent nearly a decade in prison. But the status quo has given him untrammelled power over his tribe and a fund of gas royalties amounting, by one estimate, to 120m rupees a year. Nonetheless, since Bugti tribesmen arose against the government in January, to decry the rape of a female doctor at the Sui gasfield, he has appeared to adopt the nationalist cause. “It's not all about pounds, shillings and pence. Man cannot live on bread alone,” he told this correspondent—“though I'm sure it was not an Englishman who said it.”

After shelling its own citizens in Dera Bugti, the government backed down. In effect it agreed a truce with Mr Bugti and withdrew some troops from his area. Even before considering the parliamentary committee's recommendations, in fact, the government had some sensible policies on Baluchistan in place. There is a plan to raise a 25,000-strong Baluchi border force, whose recruits will be subject to less stringent educational requirements than normal. Several new army bases are also planned for the province. Though unpopular with the nationalists, these will boost local businesses.

If such measures were to be reinforced by the adoption of at least some of the committee's recommendations, Pakistan's government could go a long way towards satisfying the demands of Baluchistan's aggrieved people. All the same, when Mr Bugti says that money is not the whole answer, he has a point. In Quetta and other towns, the BLA has strong support among educated young people. Typically, they are not only unemployed but also—since Mr Musharraf launched his coup in 1999—disenfranchised. At a dubious election in 2001, the president's supporters ensured that a coalition of Islamists from the Pushtun minority took over the provincial government. Without restoring real democracy, Mr Musharraf may find that the gifts he can afford to give Baluchistan are never quite enough.

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Al-Qaeda

Hunting the Hydra

May 5th 2005
From The Economist print edition

Pakistan nabs a key al-Qaeda fugitive

Get article background

LIKE the Hydra, al-Qaeda keeps losing its heads. On May 4th, Pakistan said it had captured one of the organisation's most senior operatives, a Libyan called Abu Faraj Farj al-Libbi, often described as the group's third-in-command. Mr Libbi's arrest, which came on the heels of another counter-terrorism triumph last month, when Saudi police killed a Moroccan member, Karim Mejjati, who has been implicated in atrocities in Morocco and Saudi Arabia, begged a question: how big a threat does Osama bin Laden's band of killers remain?

Operationally, not very, conventional spook wisdom suggested. Many of Mr bin Laden's henchmen have been captured or killed, including, in March 2003 in Pakistan, Khaled Sheikh Mohammed, the self-professed architect of the outrages of September 11th 2001. Few—some say, no—terror attacks have been carried out since then that can indisputably be pinned to Mr bin Laden's inner circle. The terrorist acts that have been accredited to al-Qaeda have been more loosely linked to the group, through the involvement of a militant trained in Afghanistan, for example, or through some unverifiable claim of responsibility on the group's behalf. Yet Mr Libbi was cause for concern—and so may his successor be: Mr Libbi, after all, inherited his planning duties from Mr Mohammed, who then ratted on him under interrogation. The new captive is accused of masterminding two assassination attempts on President Pervez Musharraf in late 2003. He was also in cahoots with al-Qaeda sympathisers in Britain—including several arrested in London last August—and is thought to have planned atrocities with them, in Britain and America.

Also interesting is the scene of Mr Libbi's capture, in Mardan (see map in article), in North West Frontier Province, close by Pakistan's border with Afghanistan. Since October 2001, Pakistan has sent over 70,000 troops into this border area—including into previously autonomous tribal agencies—to hunt for terrorists. In the past year, it claims to have killed or captured several hundred Central Asian, Afghanistan-trained militants in South Waziristan, the most hostile agency. If Mr bin Laden is in the vicinity, even he may be nabbed before long.

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North Korea

Testing times

May 5th 2005
From The Economist print edition

And no talks in sight

NEXT month, South Koreans had been hoping they might coax their North Korean compatriots into celebrating the fifth anniversary of the first and only summit between their two leaders, and so give North-South relations a bit of a boost. But, barring an unexpected burst of good news, by June it will also be a full 12 months since North Korea last took part in six-way talks with America, South Korea, Japan, China and Russia in an effort to strike a deal to dismantle its nuclear programmes. Hopes that it might be coaxed back to the table are fading. And there may be more explosive news to come.

This week the North again tested a short-range ballistic missile off its eastern coast; that led to speculation that it was upgrading missiles it could use to attack American bases or other targets in South Korea. It has longer-range missiles too that could strike Japan and possibly the United States. And America is increasingly worried that it might be able to mount nuclear warheads on these.

Last month, North Korea shut down its nuclear reactor at Yongbyon, but whether for maintenance or to extract fuel rods for making more plutonium for bombs (it is thought to have up to eight already) is unclear. Meanwhile, American intelligence officials, poring over satellite photographs, worry that North Korea's leader, Kim Jong Il, may be preparing an underground nuclear test at a site they are watching closely.

Such a test might be North Korea's way of forcing the world, but particularly America, to take it seriously as a nuclear power. For years it denied that it had the bomb, despite being caught out by inspectors producing more plutonium than it had owned up to. In 2002 it was also fingered by America for attempting to import materials for enriching uranium. Since then North Korea has repeatedly threatened to show off its “deterrent force”.

The other five in the six-way talks have been trying to keep diplomacy alive. South Korea has leaned over backwards to reach out to the North, despite its taunts. This week, however, its foreign minister admitted that the nuclear issue had reached a “critical moment” and that patience among the five was wearing thin. Meanwhile, North Korea said it would no longer deal with “half-baked” George Bush, despite previous demands for bilateral-only talks with America. Just bluff? No one except Mr Kim knows.

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Taiwan and China

Give us your island

May 5th 2005 | BEIJING
From The Economist print edition

But here are two of our pandas

Get article background

THE arrival in Washington in 1972 of two giant pandas from China symbolised a turning-point in the cold war. China and America, once bitter rivals, were cosying up in a common struggle against the Soviet Union. This week China has been playing the panda card again in an attempt to resolve another problem left over from the cold-war era: its stand-off with Taiwan. But traversing the Taiwan strait is proving a more difficult journey for the animals than crossing the Pacific.

The offer of a pair of pandas was made during a tour of China at the end of April by Taiwan's opposition leader, Lien Chan. Mr Lien was the first head of Taiwan's Nationalist Party, or Kuomintang (KMT), to visit China since the KMT's defeat in the Chinese civil war in 1949. Though the KMT lost power in Taiwan in 2000 and Mr Lien himself is likely soon to give up his party job, Chinese leaders feted him like a visiting head of state (even though in China's view Taiwan is but a Chinese province controlled by an illegitimate government).

Taiwan's president, Chen Shui-bian, has reacted cautiously to China's display of bonhomie, which was expected to be repeated this weekend (minus pandas) when another opposition leader, James Soong of the People First Party, pays his own first trip to the mainland since the civil war. Mr Chen has given a personal message to Mr Soong to relay to the Chinese leadership, but has not said what it is. In Taiwan's fractious political environment, Mr Chen's tacit endorsement of the opposition's overtures to China is a breakthrough in itself. Many in his Democratic Progressive Party (DPP) who want Taiwan's permanent separation from China denounced the trips, and the panda gifts.

The pandas were only the most eye-catching of the offers publicly made by China during Mr Lien's trip. China also said it would lift restrictions on Chinese tourists visiting Taiwan, though Taiwan still imposes restrictions of its own. And it agreed to open its markets wider to Taiwanese fruit, though this would account for a minuscule proportion of Taiwan's exports. What was not said was more significant. China did not dwell on its demand for the recognition of the “one China” principle, much less reunification.

China also gave Mr Lien a chance to put his views directly to the Chinese public with a speech, in Chinese, at Peking University that was televised live nationwide. Mr Lien, to the annoyance of the DPP, avoided any reference to Taiwan's claim to statehood. But he did call for the preservation of the status quo across the strait and drew attention to China's lack of democracy. That Chinese leaders were willing to give him a platform to make such points was remarkable enough.

So what of the pandas? The mayor of Taipei, Ma Ying-jeou of the KMT (a favourite to succeed Mr Lien), has said his city's zoo would welcome them. But the government, wary of being accused of panda-hugging by supporters of Taiwanese independence, has said it will have to examine whether it is appropriate to allow the importation of such an endangered species. In fact, there have been ten offers of pandas over the years, all rejected. China's furry envoys look set for a long wait.

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Illegal logging in Indonesia

Tackling wood-nappers

May 5th 2005 | JAKARTA
From The Economist print edition

The new government gets tough

Get article background

DAMNING reports about the damage done to Indonesia's forests by illegal logging are nothing new. Nor are government promises to do something about it. In February, for instance, a group called the Environmental Investigation Agency (EIA) alleged that $600m-worth of timber was being smuggled from Indonesia to China every month, with the active help of the army and police. Susilo Bambang Yudhoyono, Indonesia's president, duly pledged a crackdown in March. But Operation Sustainable Forest, as the resultant campaign is known, does stand out from its many predecessors in one respect: it appears to be yielding some results.

The authorities say they have arrested 157 people in Papua province, the focus of the EIA's report, since the campaign began, and another 250 or so elsewhere in Indonesia over the past six months. Previous crackdowns have netted mainly labourers hired to cut trees down, or sailors paid to transport them. But this time, the detainees include a few policemen, soldiers, and forestry officials—who are often accused of complicity in illegal logging, but seldom prosecuted. The police have even asked the financial-crimes unit to investigate the accounts of a few suspected masterminds.

Activists at WALHI, an environmental group, concede that for the time being at least, the campaign must be working, since businesses are complaining of a shortage of timber. Nonetheless, the government's new-found resolve is only scratching the surface of the problem. The EIA report claimed that Indonesia was losing an area of forest the size of Switzerland every year. The government itself estimates that illegal logging costs it $3 billion a year in lost revenue, not to mention the environmental damage.

In private, officials concede that the army, police and bureaucracy are in on the illicit timber trade up to their necks. Yet no one more senior than a colonel has been arrested so far, while the army spokesman insists that only a few bad apples are involved. What is more, Indonesia's vague laws and corrupt courts provide wood-nappers with plenty of opportunities to elude justice. Both the central government and district chiefs claim the right to issue logging permits, while the role of indigenous people is also in dispute. There is such a glut of contradictory regulation, in fact, that Mr Yudhoyono had to issue a special order to local authorities to repeal ordinances in contradiction with the national forestry law.

But the biggest flaw in the government's campaign is its emphasis on cutting off the supply of illegal logs, rather than reducing demand for them. China, for one, is importing ever-increasing amounts of Indonesian timber. In theory, the export of any unprocessed logs is illegal. But as the EIA report suggests, the law is observed mainly in the breach. Malaysia helped to reduce the flow of contraband timber from Indonesia by introducing a reciprocal law banning imports last year. But Chinese officials have repeatedly shrugged off any responsibility, most recently at a meeting in Jakarta last month.

AFP

Lovely logs, no questions asked

The volume of wood consumed by domestic firms, in turn, dwarfs exports. The Ministry of Forestry authorises an annual harvest of roughly 20m cubic metres (700m cubic feet) of timber, but the capacity of Indonesia's paper- and saw-mills is three times bigger. The government is reluctant to shut down unlicensed mills for fear of putting tens of thousands of labourers out of work, and denting Indonesia's exports of paper, plywood and the like, which bring in $4 billion a year.

In the long run, economists argue, the government should concentrate on adding value, rather than volume, to its timber exports. But manufacturers of all stripes are struggling in the face of poor infrastructure, onerous regulation and endemic corruption. Investors are wary of the wood-processing industry, in particular, after Indonesia's timber barons took advantage of the Asian financial crisis of 1997-98 to default on billions of dollars worth of loans. It will take more than a few arrests, sadly, to uproot illegal logging in Indonesia.

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Nepal

The king's new clothes

May 5th 2005 | DELHI
From The Economist print edition

King Gyanendra courts approval

HAVING revived absolute monarchy on February 1st, Nepal's King Gyanendra is now trying to persuade the outside world that he is a democrat at heart. On April 29th, he lifted the state of emergency imposed when he sacked his government three months ago. This week, several prominent political leaders were freed from detention. Some mobile-phone connections, cut as part of the king's well-executed coup, were restored. All of this, however, seemed aimed less at returning fundamental freedoms than at winning some foreign support for his army's fight against a nine-year Maoist insurgency.

The king had been ostracised by neighbouring India immediately after his putsch, and his change of tune came on his return from international conferences in China and Indonesia. He had met India's prime minister, Manmohan Singh, and promised an early “road map” back to constitutional rule. The state of emergency would have expired anyway at the end of April. Renewal would have been embarrassing.

Even without the emergency, protests in Katmandu, the capital, are banned, though groups of trade unionists and journalists staged street demonstrations this week. Censorship remains strict and hundreds of people are in detention for political reasons. On May 2nd, the detentions of 175 of these were extended for a further three months.

The king is hoping, however, that he has done enough to allow India to renew arms supplies, which, like Britain, it suspended after the coup. India seems likely to yield. He has always played on its fear of a Maoist victory, which would encourage India's own widespread if low-level Maoist insurgency.

The war, which has already taken more than 11,000 lives, was the king's pretext for seizing power. He argued that bickering and indecision among the political parties were impeding the military campaign. Yet the main beneficiaries of his move, which split the constitutional monarchy from the parties, were the Maoists themselves.

Now, however, they too are suffering division. The group's leader, known as Prachanda, has accused one of his chief lieutenants, Baburam Bhattarai, of “serious deviation” and of building his own faction. The Maoists are a secretive as well as brutal bunch, and it is unclear how serious this top-level tiff is. To hope they will tear themselves apart may be as naively optimistic as to predict a decisive victory for the royal army.

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Justice versus reconciliation

Hunting Uganda's child-killers

May 5th 2005 | GULU AND KITGUM
From The Economist print edition

AP

A ghastly civil war provides a test case for the International Criminal Court

Get article background

NO ONE doubts that terrible crimes have been committed in northern Uganda. The Lord's Resistance Army (LRA), a rebel group led by Joseph Kony, a man who thinks himself semi-divine, has spent the past 18 years slaughtering peasants, enslaving children and slicing off the lips and noses of conscripts it suspects of disloyalty. But does this mean that the newly established International Criminal Court (ICC) should be going after Mr Kony and his lieutenants? Several community leaders in northern Uganda think not.

As the ICC prepares to issue its first arrest warrants against the LRA's leaders, Rwot Acana II, the paramount chief of the northern Acholi people, who have borne the brunt of the rebels' atrocities, predicts that it will be “the last nail in the coffin” of a fragile peace process. The threat of prosecution, he argues, will deter the rebels from accepting a government-offered amnesty, and therefore prolong the war. He and other Acholi leaders have been furiously lobbying the ICC to back off. They argue that it would be better to apply traditional Acholi justice. If the rebels confess their guilt and undergo cleansing rituals, they will be accepted back into their communities, say the ICC's critics.

The ICC was first invited to consider the northern Ugandan conflict in January 2004, by the Ugandan government. Earlier this year, the government appeared to be having second thoughts. President Yoweri Museveni spoke of “convincing the ICC to drop their indictment if the LRA rebels surrender”. But Luis Moreno-Ocampo, the court's chief prosecutor, turned a deaf ear, and the government has now relented. Mr Moreno-Ocampo is expected to apply to the court's pre-trial chamber for arrest warrants against half a dozen rebel chiefs by the end of this month.

Mr Kony's gang has reportedly abducted more than 20,000 children. Some are forced to fight, some to carry bags, others to have sex with the fighters. By way of initiation, many are obliged to club, stamp or bite to death their friends and relatives, and then to lick their brains, drink their blood and even eat their boiled flesh.

Nearly 2m people, representing some 90% of the population of the three main Acholi provinces of Gulu, Kitgum and Pader, have fled their homes and now live in crowded and unhealthy camps. Even here, they are at risk. Every night, streams of bare-footed children trudge miles to sleep in the relative safety of the main towns, before returning home at dawn.

The force that terrorises them remains shadowy. Mr Kony, who was raised, like most Acholis, as a Catholic, claims to have been sent by God to save his people from evil, a heading under which he includes President Museveni and all forms of witchcraft. He says he wants to rule Uganda in accordance with the Ten Commandments, though he has at times made more prosaic demands, including education for all, an independent judiciary and policies to encourage foreign investment.

No one knows how many troops Mr Kony commands. Some say he once had as many as 10,000; others that he now has only a few hundred. Betty Bigombe, the chief mediator between the government and the LRA, reckons there are about 3,000 “rebels” left, of whom 800 are fighters. Since Mr Museveni's forces number 100,000 or so, including militias, many northerners wonder how hard the government is really trying to crush the rebellion.

Fewer places to hide

That said, peace looks more likely now than for a decade. Pressure on the rebels has increased since the government of neighbouring Sudan agreed in 2002 to stop backing them. It has also allowed Ugandan forces to attack Mr Kony's bases in southern Sudan, and last month, the two countries mounted their first joint military operation against the LRA.

This, combined with the amnesty, has flushed thousands of rebels out of the bush. Despite the vaunted Acholi tradition of reconciliation, many have found it hard to rejoin their own communities. Hundreds have joined the army instead, and are now hunting their former comrades. Others have hidden to escape the wrath of their families. But Mr Kony and his top commanders have not been lured out—and many suspect they never will be.

The ICC's supporters argue that it can help end impunity, which was why it was first set up in 1998. If Mr Kony is brought to justice, it may deter others currently contemplating mass murder. And despite the fears of Acholi leaders—which not all Acholis share—it does not seem to have impeded the peace process in northern Uganda. Some argue that, on the contrary, it has increased the pressure on rank-and-file rebels to turn themselves in.

But the ICC has no police force. How, ask the sceptics, will it catch Mr Kony when he has evaded the Ugandan army for 18 years? The court's supporters retort that similar misgivings were voiced when the international tribunal for the former Yugoslavia was set up, yet Slobodan Milosevic, the former Serbian president, and most of his generals are now in the dock.

Since this is its first test case, the ICC is determined to succeed in northern Uganda. Its credibility is at stake. Catching Mr Kony may take years or even decades. But unlike other international tribunals, the ICC is permanent. There is no time limit for its work. Its indictments, once issued, remain in force until the indictee is either tried or dead. It can wait for Mr Kony, who may incidentally be running out of hiding places.

His fellow Acholis hate him. His friends in Sudan are turning their backs on him. Donors are pressuring Mr Museveni to pacify the north (and to abide by constitutional term limits, but that is another story). Mr Kony might hope to hide in a state that is not a party to the ICC. But who would want him?

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Congo-Brazzaville

Laughing looters

May 5th 2005 | BRAZZAVILLE
From The Economist print edition

The smaller Congo's problems loom large

Reuters

A sticky road to peace

FOR six years, Congo-Brazzaville has been not exactly at war, but not exactly at peace, either. A full-scale civil war ended in 1999, but a fresh insurgency erupted in 2002. It remains unquelled, as your correspondent found out when a UN convoy he was riding in was held up by drunken “Ninja” rebels armed with guns and hoes. One of the Ninjas, who called himself “Laughing Cow”, after the popular brand of soft cheese, tapped on the car window with a hand holding two grenades and a reefer. He then climbed in and pressed the grenades to your correspondent's head. He removed them, however, in exchange for an old pair of walking boots.

Congo-Brazzaville is often ignored, not least because its woes are dwarfed by those of the other Congo, its vast and bloody neighbour. Western donors are spending billions trying to reassemble the larger Congo (the Democratic Republic), but in little Congo-Brazzaville, the UN said last month that it had received only 3% of the $22m it needed to tackle a humanitarian disaster.

There are no UN peacekeepers in Congo-Brazzaville, and it shows. President Denis Sassou-Nguesso's government seems either reluctant or unable to pacify the Pool region, between the capital and the coast, where the Ninjas roam freely. They shaved off their dreadlocks this year to celebrate progress towards peace and elections, but they still loot the odd train and some of the few vehicles that venture into their territory.

Fighting between the army and the Ninjas has killed thousands and displaced perhaps 150,000 civilians. The Ninjas' leader, a mystical cleric named Frédéric Ntoumi, agreed to make peace in 2003, but plans to disarm his estimated 5,000 rag-tag fighters have been repeatedly delayed. Last year, the European Union cut funds earmarked for disarmament, citing fears that the money would be misused.

Congo-Brazzaville is sub-Saharan Africa's fourth-biggest oil producer , but it does not look rich. The paved roads in Brazzaville, the capital, crumble before leaving town. According to the UN, the proportion of children in the Pool vaccinated against tuberculosis has plummeted from 90% in 1990 to 37% in 2000. Over roughly the same period, the proportion attending school has dropped from 82% to 48%. The UN has recently opened an office in Kinkala, the main town in the Pool, and a few charities run health centres and help keep schools open. Without their efforts, these services wouldn't exist, says a UN official.

The attack on the UN convoy, which took place on April 23rd, ended without casualties after older and soberer Ninjas arrived, shot their guns into the air and demanded that their comrades leave the UN alone. The hijackers still escaped with radios, mobile phones, cash and some industrial-sized boxes of condoms, which a 13-year-old soldier proceeded to distribute.

Two days later, Mr Ntoumi, the rebel boss, said he planned to disarm his men, but that he would not hand over their weapons until he reached a political deal with the government. The Ninjas' political wing hopes eventually to take part in elections, but President Sassou-Nguesso has a habit of banning his opponents from standing for office.

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Israel's schools

A lesson in listening

May 5th 2005 | JERUSALEM
From The Economist print edition

An overhaul of education risks sinking in recriminations

AN UGLY showdown is looming. This week Israel's government began sending dismissal notices to 4,500 of the country's 110,000 schoolteachers. If it can reach a deal with unions by May 31st—the legal deadline for dismissing teachers before the next academic year—it will fire less than half as many. But for that the unions would have to accept reforms that they say would ruin the system.

Most Israelis agree that their schools are in bad shape. Their complaints sound much like those anywhere: falling standards, growing indiscipline, violence and so on. Claims that Israel led the world in the 1960s and 1970s are exaggerated, says Or Kashti, the education correspondent of the daily *Maariv*: early comparisons were based on selective data. Nonetheless, Israel now does worse than the rich-country average (but better than its neighbours).

That stings. Israel relies on a high-tech economy and takes pride in an educated populace. Last year a governmental commission headed by Shlomo Dovrat, a businessman, produced a thick dossier of proposals. Many were inspired by reforms pioneered in England and since emulated, to varying extents, in much of the English-speaking world. Budgeting and decision-making will be decentralised, with much more power given to head teachers, leaving the government to do little but set the curriculum. Schools will get money per pupil instead of per class, and extra money for those from poor backgrounds. School districts will be opened up, giving parents more choice. There will be a national curriculum, an evaluation body like England's Ofsted and league tables. Pupils will study five days a week instead of six, for longer per day. About 1,000 small schools will be closed and the three stages of primary, middle and secondary school will be merged into two.

Importantly, says Dan Gibton, an educational-reform expert on the commission, this will all be done in law, making it transparent, and harder for subsequent governments to mess with. The teachers, armed with the experience of their colleagues in other countries, have a correspondingly weighty pile of objections.

The system will discriminate against older, experienced teachers, they say. Giving parents a free choice of school could widen the gap between the best- and worst-performing pupils. There are doubts that the education budget, which has shrunk steadily for years, can accommodate the changes. New school hours, around which so much in society revolves, will cause havoc. Head teachers will play the league tables by shedding their less able pupils.

Overall, say many, in another echo of England's education wars, the Dovrat report is too results-based. “It deals only with the structure of the system and not the content,” says Yair Rubin, a teacher. “It doesn't deal with education, but with teaching.” Many of the proposals are good, says Mr Rubin: he likes the idea of a core curriculum (though is alarmed by some of what it contains), autonomy for head teachers, annual evaluations, and a proposal to bring religious and independent schools under tighter state control. He is also critical of the unions' knee-jerk rejection. “But the Dovrat proposals need improvement, and that can only be achieved by negotiation.”

Alas, whatever the merits, negotiation now seems impossible. What enraged the unions was not just what the commission decided, but how. To prevent its politicisation, they were excluded from it (as were education-ministry officials), though they had many meetings with commission representatives. Worse, Binyamin Netanyahu, the finance minister, who is fervently promoting Thatcherite economic reforms, is now holding the unions to ransom. If the Dovrat proposals are adopted, he will return the education budget to its 2003 level; if not, he will implement a further deep slash: hence the 4,500 redundancies.

Maybe the reforms are necessary, says Etti Chasson, a middle-school teacher in Jerusalem, “but we're being kicked out in the most brutal way”. Mr Gibton admits that not involving the unions from the start “might have been a mistake”. Israel's unions are stronger than England's, and its governments are weaker. The reform was due to come into force this autumn; if the teachers opt for an all-out strike (and they have few other weapons), it may have to be delayed. In its zeal to give the system a real overhaul, the government may have scuppered its chances.

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Iran's economy

Could do better

May 5th 2005 | TEHRAN
From The Economist print edition

The conservatives' xenophobia deters investors

AN AIR of farce clings to Muhammad Khatami's efforts to bequeath to Iranians a world-class airport before his eight-year stint as Iran's first reformist president ends this summer. Almost exactly a year ago, his conservative opponents in the Islamic Revolutionary Guard Corps (IRGC) seized the Imam Khomeini International Airport after just one plane had landed. Last week, the airport's (re-)inauguration was spoiled by warnings from the British and Canadian governments that its runway might be unsafe. Amid calls in parliament for his expulsion, Britain's chargé d'affaires was forced to deny that the warning was politically motivated.

Politics has dogged the project from the start. Ahmad Khorram, the then transport minister, irked Iranian nationalists when he invited Tepe-Akfen-Vie, a Turkish-dominated consortium, to build and run the airport's first phase; the guardsmen are said to have been piqued that conservative Iranian companies were denied the contract. Later, domestic rivalries led Iran's IRGC-friendly parliament to impeach Mr Khorram and to force changes to another big contract, under which Turk Telecom was to set up and operate a mobile-phone network. It looks as though the conservatives, who dislike Mr Khatami and distrust secular Turkey, have had their way: both Turkish firms look likely to retreat.

At what cost? Many outsiders, not all of them Turks, doubt whether Iranian companies have the wherewithal to build the airport's second phase. Until that is finished, most international flights will continue to use Tehran's old airport, an inconvenient half-hour drive away. And a shadow has fallen over Mr Khatami's reputation as a cautious promoter of foreign investment. In that, as well as his still-born democratic reforms, the president is likely to be remembered more for his intentions than his achievements.

Again, politics is partly to blame. In 2002, hot on the heels of well-received legislation to woo foreign investors, Iran's American critics began arguing that its nuclear programme should be referred to the UN Security Council; sanctions could follow. That threat has not receded; negotiations between Iran and three European countries have made little progress. Then, last year, conservatives took control of parliament and quickly drew fire for their chauvinism and fiscal profligacy.

Foreigners observe warily. Iran's large, youthful population and oil wealth mean that Tehran's trade fairs are still well attended, but investment is thin on the ground. According to Saeed Leylaz, an economist, inward foreign investment outside the oil and gas sectors in the year to March 2005 totalled a paltry $1 billion.

Some Iranians sigh that they are the victims of their own mineral riches. Since the price jump of 1999, bumper oil receipts have excused politicians from undertaking the painful task of tackling the structural deficiencies and isolationist thinking that have contributed to Iran's economic woes. Even the oil and gas industries, which have been open to foreigners since 1995, are not the exceptions they should be. Tendering procedures are slow and politicised. Some foreign contractors are threatening to pull out of Iran; they complain of wasting large sums chasing contracts whose winner, they suspect, has often been predetermined.

Some big deals trickle through the system, but the oil minister's recent call for $150 billion of new investment to double production is unrealistic. American sanctions and internal politicking mean that Iran has trouble maintaining current levels. And, despite having the world's second biggest reserves of natural gas, Iran has made a bad job of attracting investment, and remains a net importer.

Eyes are fixed on June's election. Most foreign investors would prefer Ali Akbar Hashemi Rafsanjani, a

former president and likely candidate, to defeat his putative conservative opponents; reformist candidates are expected to be barred from standing. For reasons of expediency, Mr Rafsanjani is a liberaliser, and he is good at clearing logjams. If he is elected, things might get better. In the meantime, if you have a connecting flight in Tehran, give yourself plenty of time.

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Victory Day, 60 years on

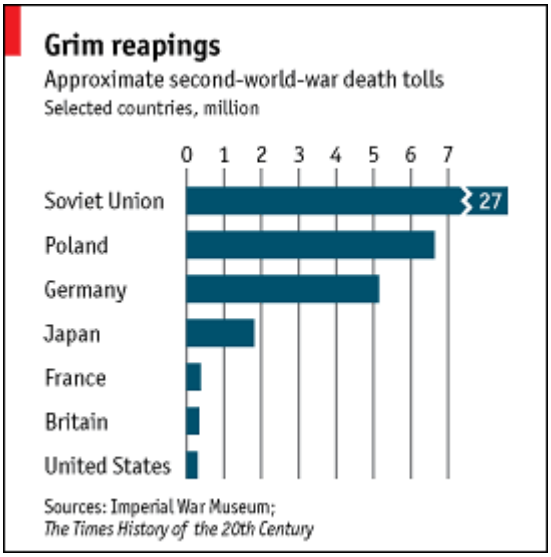
The uses and abuses of history

May 5th 2005 | MOSCOW
From The Economist print edition

EPA

Russia's complicated attitude to the best and worst of times

THE trouble with Russia, runs one diagnosis of its post-Soviet condition, is its faulty memory. Where, western observers (and some Russians) ask, are Moscow's memorials and museums to victims of the purges, gulags and famines? Where is the equivalent of a German (or South African) official reckoning? Yet, across Russia this week, in omnipresent Victory Day posters and on television, a different kind of memory has been everywhere.



Russians are often baffled and angered by western accounts of the second world war—and justifiably so. During the conflict, the Soviet Union was an admired ally; but after the long years of cold-war confrontation, how many Britons or Americans now know that more Soviet citizens (27m) died as a result of the war than all the other allies lost together (see chart)? Or that the fighting in the east accounted for over three-quarters of all German military casualties? Almost every Russian lost a relative. Out of respect for their dead, newlyweds pose for photographs in front of Moscow's main war museum. Everybody, it

seems, has a war story. Vasily, a middle-aged doctor, remembers hearing how, to stay warm and dry, Red Army soldiers slept under and on top of each other at the battle of Stalingrad. “It's immoral to discuss it,” Colonel-General Anatoly Mazurkevich replies sharply, when asked about differing versions of the allied victory.

Yet Russia's attachment to the war is proportionate not only to the Soviet Union's incomparable losses. It also reflects the grind and humiliations of Russia's post-war history.

Andrei Zorin, a Russian cultural historian at Britain's Oxford University, explains that Victory (in Europe) Day—which George Bush, Gerhard Schröder and Jacques Chirac, with many other world leaders, will mark with Russia's Vladimir Putin in Moscow on May 9th—is the only public holiday that all Russians can agree to celebrate. The older, communist ones have been forsaken, and their replacements haven't taken root. More than this, defeating Hitler is for many Russians the last (and perhaps only) unquestionably good thing their country ever did. Communism's shibboleths have been discredited; its fall is associated with poverty, criminality and declining life expectancy. Many Russians might well agree with Mr Putin's description last week of the Soviet Union's collapse as the greatest geo-political catastrophe of the 20th century.

That is why the principal audience for the Kremlin-sponsored pomp and pageantry next week will be a disillusioned domestic one. This may help to account for Russian reluctance to acknowledge the Soviet Union's sins before, during and after the war, such as the Katyn massacre of Polish officers in 1940, the atrocities committed as the Red Army marched on Berlin or the Molotov-Ribbentrop pact of 1939 that carved up Europe. (The pact, argues Vyacheslav Nikonov, a political analyst and Molotov's grandson, was in any case annulled when Hitler invaded in 1941.) This reluctance angers many Europeans, and has even kept some Baltic leaders away from next week's festivities (see article). Yet it derives partly from Russia's need, in its weakened state, to cling to something unequivocally good.

But only partly. For there is another, less sympathetic and more worrying explanation for Russians' nostalgia for the Great Patriotic War, which to them began in 1941, and was won more or less by themselves alone. (Russians are still aggrieved about how the war was fought, as well as how it is remembered. When they meet a westerner, even some Russians born long after the war will often demand to know why Churchill and Roosevelt waited until 1944 to open a second front.) Russians revere the victory not only because it was just, but also because it secured the Soviet Union's great-power status, whose loss, says Alexei Levinson, a sociologist, many Russians feel like the pain of a phantom limb. That pain stands behind what, to foreign observers, seems a wilfully forgetful attitude towards Stalin.

Take a stroll in the Alexandrovsky gardens, under the Kremlin's walls, and you encounter the engraved names of the Soviet Union's most heroic wartime triumphs: Kiev, Leningrad, Sebastopol—and Stalingrad. The name on the inscription for this last battle was changed from Volgograd, which the city has been called since 1961, to its wartime version only last year.

What is surprising about Russian perspectives on Stalin is not that the odd eccentric town council has made an official bid to rehabilitate him, or that a couple of others want to erect statues in his honour. It is that, according to opinion polls, a sizeable minority of the population still holds favourable views about a man who froze, starved to death or shot millions of his own citizens. Respect for Stalin is strongest among the old, the poor and the badly educated, as well as among residual communists, some of whom still leave flowers on his monument in Red Square on the days of his birth and death.

Even many of those who criticise Stalin tend to do so indulgently, especially where his dreadful military blunders and wartime crimes are concerned: the pointless army purges; the monstrous and mindless sacrifice of lives; the execution of tens of thousands of Soviet soldiers; and the persecution of returning prisoners-of-war. Not to mention the wholesale deportation of the Chechens and other Caucasian nationals, whose consequences Russia is still living with (the strong-arm security in Moscow this weekend is designed to foil a feared terrorist strike on May 9th). Vladimir, a veteran who lost his father and two brothers in the fighting, now says that Russia would not have won the war without Stalin. Even young people feel likewise. Dmitri, a young, westernised lawyer, says that, with somebody like Mikhail Gorbachev or Boris Yeltsin in charge, Russia might well have lost.

Russia's anguished liberals are fond of comparing Mr Putin to Stalin, adducing his KGB instincts and his subversion of independent media, the courts and parliament. Whatever Mr Putin's failings, the comparison is absurd on its face. Yet he does represent, and appeal to, the strain of Russian thinking that yearns after the greatness that Stalin—rather like such tsars as Ivan the Terrible—engineered.

Individual Russians, says Mr Levinson, the sociologist, can both loathe and revere Stalin, just as they can simultaneously be both self-deprecating about their country and fiercely proud of it. These, Mr Levinson says, are “two inseparable parts of the contemporary Russian mind.” Unless they resolve their contradictory attitudes to their rulers and their country's place in the world, Russians may be fated, if not to another Stalin, at least to more Putins.

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Baltic borders and the war

Frontier justice

May 5th 2005 | TALLINN
From The Economist print edition

Why Russia's borders with the Baltic countries remain disputed

Get article background

THE fighting stopped 60 years ago, but the war still produces lively rows. Estonia and Lithuania are boycotting next week's shindig in Moscow. Latvia's president, Vaira Vike-Freiberga, is going only to question Russia's interpretation of history. This is as follows. The Baltic three were annexed in 1940 by the Soviet Union “according to international law at the time”; then conquered by the Nazis; and then liberated by the heroic Red Army.

For the Balts, this is topsy-turvy. Far from being legal, their annexation stemmed from the 1939 Nazi-Soviet pact, which divided Europe between the two. The Red Army's arrival in 1945 was less a liberation than the replacement of one murderous occupation by another. If anything, the Soviet one was worse (though not for Baltic Jews). The re-establishment of pre-war independence in 1991 was a miracle, not a catastrophe.

What the Balts want is for Russia to be like Germany, apologising and paying compensation to victims of totalitarianism. That is fanciful. Far from being penitent, Russia is becoming more nostalgic for the Soviet Union. One aide to Mr Putin calls the Baltic view of history “blasphemous”. Russia prefers to complain about Soviet-era Russian-speaking migrants to the Baltic, who mostly have to pass a language exam for citizenship.

All of this is holding back ratification of the Estonian and Latvian border treaties with Russia. These mark the Balts' renunciation of some strips of pre-war territory taken by Russia during the Soviet era (see map). Although they were agreed on years ago, Russia has put off signing in the hope of extracting more concessions or impeding the Baltic countries' entry to the European Union and NATO. The Russians had planned to sign the Latvian treaty on May 10th. Yet when the Latvians issued a declaration saying that accepting the Soviet-era border with Russia did not mean they had backed down on other issues, such as compensation for former Gulag inmates, the Kremlin cancelled the signing.

Latvia may have been unwise. Estonia, which Russia has invited to sign its treaty on May 18th, has issued no declaration. One sympathetic official says that the Balts suffer from “political Tourette's syndrome” on Russia, “coming out with random insults in public and being unaware of the effects”. Some think the Balts should all have gone to Moscow. That was the decision taken by Poland, which has a

similar view of history. “Russia wants to make out that the Baltic states are in some different category from the rest of the European Union,” says an official. “So providing any evidence for this is ill-advised.”

The EU is largely unhelpful, even though all three Baltic states joined last year. EU officials see the border treaties as bilateral matters. There is little solidarity among the Balts, either. Steely Mrs Vike-Freiberga gets on badly with Estonia's Arnold Ruutel, an old-style bureaucrat, and Lithuania's doddery Valdas Adamkus. The inability to agree on a common line over going to Moscow highlighted this lack of trust—and the success of Russia's policy of divide and, perhaps, rule again.

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Turkey and the Middle East

Erdogan's travels

May 5th 2005 | ANKARA
From The Economist print edition

The Turkish prime minister's visit to Israel was aimed partly at America

AFP

Turks on Temple Mount

"A NEW friendship" is how Israel's *Haaretz* daily headlined its musings on the Turkish prime minister's visit this week. In fact Turkey's friendship with Israel, underpinned by trade and military co-operation, is among the oldest and strongest in the region. Yet since becoming prime minister two years ago, Recep Tayyip Erdogan has spurned invitations to Israel, saying he was too busy—even though the bilateral relationship seemed in danger of unravelling last year, when Mr Erdogan accused Israel of perpetrating "state terrorism" against the Palestinians.

The conventional wisdom is that Mr Erdogan was appeasing pious constituents embittered by his failure to meet promises to ease restrictions on the Islamic headscarf and religious education. He may also have fallen prey to advisers with visions of Turkey again leading the Muslim world. Yet this week, flanked by his scarved wife, Emine, and an army of Turkish businessmen, politicians and military officials, Mr Erdogan assured Israel's prime minister, Ariel Sharon, that his Justice and Development (AK) party saw anti-Semitism as "a crime against humanity". He added that Iran's nuclear ambitions were a threat not just to Israel but to "the entire world".

What prompted the visit now? Mr Erdogan said it was to propose his services as a mediator between Israel and the Palestinians. But most pundits scoff at this (as did the Israeli foreign minister, Silvan Shalom). Instead, they see the visit as part of a campaign to repair Turkey's relations with America. That thought must have crossed the mind of the Palestinian prime minister, Ahmed Qurei, when Mr Erdogan showed up two hours late for a meeting after an unscheduled encounter in his Jerusalem hotel with America's Senate majority leader, Bill Frist. Mr Qurei cancelled, apparently complaining that Turkey had more time for Israel and the Americans.

Turkey's recent tensions with Israel mirror its deteriorating ties with America. Some in the AK party have accused both countries of harbouring secret plans to establish an independent Kurdish state in northern Iraq, which could become a magnet for Turkey's own rebellious Kurds. Rich Israeli Jews with Kurdish roots have allegedly been buying land in northern Iraq and in Turkey's mainly Kurdish south-east. For similar reasons, say conspiracy theorists, the Americans are refusing to dislodge separatist Kurdish PKK rebels from their mountain bases in northern Iraq. Mr Erdogan's description of Iraq's Sunni insurgents as "martyrs" and his dismissal of the election in Iraq as anti-democratic have not helped relations.

Some speculate that Mr Erdogan has allowed his ties with Washington to sour because of his new confidence in the European Union. Yet by his own admission, this has waned since last December, when EU leaders agreed to start accession talks with Turkey next October, but attached a slew of new conditions to putative Turkish membership. "Something broke in me that day," Mr Erdogan told the newspaper *Milliyet*, amid news that his government had agreed to a ten-month-old American request for expanded use of the Incirlik air base in southern Turkey.

Mr Erdogan's fresh embrace of Israel and America has been spurred also by fears of falling behind changes in the Middle East. Turkish officials admit to being embarrassed by their president's visit to Syria last month, just as the Syrians were being pushed to get out of Lebanon. Democratic or not, Iraq's elections have now produced a government whose president, Jalal Talabani, and foreign minister, Hoshyar Zebari, are Kurds. In another sign that Turkey is changing tack, Abdullah Gul, the foreign

minister, signed a declaration with Iraqi and Arab colleagues in Istanbul on May 1st, pledging to support a federal structure “if that is what the Iraqi people decide”. The days when Turkey's leaders would utter warnings against federalism in Iraq, as a red line that could provoke Turkish intervention, seem to be over.

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Spies in the Vatican

Reds under the pontiff's bed

May 5th 2005 | ROME
From The Economist print edition

A tale of papal intrigue and mystery

Get article background

AFTER attending the new pope's first public audience and visiting his predecessor's tomb, the white-robed monk hastened from the Vatican. In his native land, he was being denounced as a spy. He packed and headed for Rome's Leonardo Da Vinci airport, but failed to board the flight that he had booked. An excerpt from the latest incense-and-intrigue thriller by the American novelist, Dan Brown? No: this is reality. Last week, Leon Kieres, head of IPN, the agency that keeps Poland's communist-era documents, accused a 69-year-old Dominican friar, Konrad Hejmo, of collaborating with the Polish intelligence services in the 1980s. Father Hejmo, who denied the allegation, first came to Rome in 1979, soon after his compatriot was made Pope John Paul II.

Father Hejmo's job was, at first, to compile a press digest for the Polish bishops' conference. Since 1984, he has looked after Polish pilgrims visiting the Vatican, a job that gave him routine access to the pope's household. Father Hejmo has said the allegations may spring from his innocently passing information to a man he calls M, whom he believed to be working for the German bishops' conference. But the IPN says that Father Hejmo was paid for his information, and that his secret-service dossier runs to more than 700 pages. It says it will release further details later this month. A full study of the Polish intelligence services' penetration of the Catholic church is expected later this year, but tit-bits are already leaking out.

This week a Polish magazine, *Wprost*, reported that another priest, an old friend of Karol Wojtyla identified only by the code-name “Delta”, had spied on the late pontiff. The priest—albeit still anonymously—denied the claim.

That the Holy See was a target for communist intelligence services, particularly after John Paul's election, is not in doubt. The archives of the East German secret service, the Stasi, suggest that its XX/4 section had 17 informants in the Vatican in the two decades before the fall of the Berlin Wall in 1989. Its officials knew of the details of talks between Pope Paul VI and the late West German chancellor, Willy Brandt. More intriguingly, they knew of the movements of Ali Agca, the man who tried to assassinate the pope in 1981.

Does anybody need to know about what goes on behind the walls of the Vatican now that its old enemy, atheist communism, is extinct in Europe? Less than before, perhaps. But Russia and China view Catholicism with suspicion. And the turnout by heads of state and government for John Paul's funeral underlined the importance that is still attached to the Holy See's “soft power”. For as long as that power persists, there will be work for spies in the Vatican.

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Germans and Jews

Uncertain normality

May 5th 2005 | BERLIN AND JERUSALEM
From The Economist print edition

Some forgiving, not much forgetting

BERLIN'S new Holocaust memorial is being inaugurated, on May 10th, almost exactly 60 years after the end of the second world war. In some ways, the monument could be seen as an attempt to state that German-Jewish relations have become normal. Situated in the heart of the capital and made up of 2,711 concrete pillars that form a huge undulating plain reminiscent of an old Jewish cemetery, the memorial seems to say: “We acknowledge our guilt; let's look to the future.” But getting this far has been a long and, at times, tortuous business—as two other imminent anniversaries show.

The first also falls next week, on May 12th, which will mark four decades since Israel and West Germany established diplomatic relations. The second is that, in July, 15 years will have passed since East Germany opened its borders fully to Jews from the former Soviet republics.

It would have been understandable, perhaps, had Israel refused to establish any formal ties with the Germans. But in 1965, needing a strong European ally, the country decided otherwise. Germany is now one of Israel's main partners, in some ways second only to America. And on the face of it, bilateral relations could hardly be better. The two countries have signed two dozen agreements covering everything from taxation to film-making. Researchers, armies, even spies work closely together. Germany is Israel's biggest market in Europe; Israel is Germany's biggest in the Middle East. Almost 100 cities are twinned. Over the years thousands of young Germans and Israelis have taken part in exchanges.

Perhaps more surprisingly, Germany now has Europe's third-largest Jewish population, thanks not just to open immigration (mostly from ex-Soviet places) but also to generous welfare payments. Last year, much to the Israelis' chagrin, twice as many Jews from former Soviet republics settled in Germany as in Israel, bringing the total inflow to more than 200,000 since 1991. About half have joined a settled Jewish community, of which there are now more than 100, with a total of 100,000 members—up from 30,000 before unification. Some German cities have seen a revival of Jewish culture, particularly Berlin, where 3,000 Israelis also live.

Yet these promising signs tell only part of the story. Even those involved accept that, in Israeli-German relations, “the ice is still thin.” History can get in the way. To mark the 40th anniversary of their relationship, the two countries wanted to issue a common stamp; yet controversy erupted when Israeli politicians said it should show not only both countries' flags, but also a barbed-wire symbol to recall the Holocaust. There may be no stamp.

To be sure, attitudes are changing. Holocaust-related news from Germany, such as an anti-Semitic speech by a conservative politician in 2003, no longer triggers a storm of anti-German commentary in the Israeli media. Germany's ambassador to Israel is invited to the annual Holocaust commemoration at Yad Vashem. A controversial Hitler movie, “Downfall”, will be shown in Israel, after 91% of test viewers voted for its release. Still, in a recent poll of young Israelis, some 37% saw a Nazi comeback in Germany as possible.

In Germany, meanwhile, the Palestinian issue has been changing views. According to a 2004 poll by Bielefeld University, more than 80% of Germans say they are “angry” over how Israel treats the Palestinians. Astonishingly (as if the gas chambers and 6m murders were a detail), about 50% share the view that what Israel is doing to Palestinians today is “in principle” nothing else than what the Nazis did to the Jews during the Third Reich.

Yet, for Germany's reviving Jewish community, the main challenge is not anti-Semitism, but integration.

Socially, Jewish immigration has been a failure. Over 80% of the Jewish newcomers live on welfare. Most do not speak German. Many are near or past retirement age. Moreover, their academic degrees are not recognised. Germany may lack doctors in some rural areas, but a top physician from Russia is not allowed near a patient.

When it comes to religious life, the situation is little better. Many Jewish groups, some of which have seen their membership grow twentyfold, lack the resources to pay for a rabbi. Government subsidies, their main source of income, have not risen to match growing numbers. What is more, established German Jews feel pushed aside by Russian-speaking newcomers. In some communities, the telephone is answered only in Russian.

Before things get better, they may get worse. Israel frets that Germany's foreign policy will be driven more by European consensus than by historical obligations—and will thus become more pro-Arab. Also, the culture of commemoration in the two countries may drift apart. Much German media coverage of the 60th anniversary of the end of the war has focused on German suffering. As many as 60% of Germans say they are tired of being reminded of their country's crimes against the Jews.

Germany's Jews face further political challenges. The Central Council of Jews in Germany, an umbrella organisation, is negotiating with the government over possible limits to Jewish immigration to Germany. Because of mounting welfare costs, the government wants to introduce social criteria, such as age, language skills and the chances of finding a job. The Central Council finds this horribly reminiscent of “selection” at Auschwitz. Yet it appears willing to agree as long as it gets more subsidies to promote integration.

Immigration has put the Central Council and its member communities in a tough spot for another reason. If they do not open up and offer better services to newcomers, they may lose their monopoly role representing Jews in Germany, who have been mostly Orthodox since the war. Some Reform communities have sprung up, leading to conflicts over government money. Chabad Lubavich, an ultra-Orthodox organisation from America, is also increasingly active, offering services that are popular even among liberal Jews.

None of this should be taken to suggest that Germany's Jewish community will fragment or disintegrate, or that Israeli-German relations will deteriorate. But it does suggest that, even 60 years on, relations between Jews and Germans are far from being “perfectly normal”. There may even be good in that—if normality were ever to imply forgetting.

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Charlemagne

Taking on the bear

May 5th 2005
From The Economist print edition

Russia's awkward position in Europe's jigsaw

FOR anyone growing up in western Europe during the cold war, Russians were only marginally more accessible than Martians. A few stock images defined the country: a gymnast, a soldier, a hatchet-faced member of the Politburo. There were no casual contacts with Russians, as the country had walled itself off. Now, however, the Russians are back: from the beaches of Cyprus, to the ski-slopes of Switzerland, to the London property market, where grateful estate agents refer to rich Russian buyers as “the new Saudis”. Chelsea has just won the English football championship for the first time in 50 years, courtesy of huge injections of cash by Roman Abramovich, a Russian oligarch. The team now runs on to the pitch preceded by the sound of Cossack music, in grateful tribute to their benefactor.

However, although it has been easy to re-admit Russians into the social and cultural life of Europe, fitting Russia into the European political order has proved harder. The cold war imposed a grim clarity on the relationship. And, before 1917, it was clear that Russia had to be a player in any conceivable continental balance of power. The 19th-century idealists who first dreamed of a united Europe assumed that Russia would be part of the new system: Victor Hugo's appeal in 1849 for European unity was addressed to Russia, as well as to France and Germany.

Yet today's European Union of 25 countries, even if it rises to 35 or more in the future, quite clearly excludes Russia. A few mavericks, such as Silvio Berlusconi, the Italian prime minister, and Grigory Yavlinsky, a Russian liberal politician, have suggested that Russia should eventually join the EU, but there seems to be little enthusiasm—on either side. The EU's ambassador in Moscow has joked nervously that it would be more a case of the EU joining Russia, than of Russia joining the EU. Given the country's huge size—it spans 11 time zones—one can see what he means. Whereas the leaders of Turkey and Ukraine speak openly and often of their ambitions to join the EU, no such talk is ever heard from Vladimir Putin. A country with recent memories of being one of the world's two superpowers cannot contemplate the relatively humbling idea of being just another member of the European club. The Brussels ideology, with its emphasis on “shared sovereignty” and the dismantling of borders, is unappealing to a Russian leadership that is more comfortable with traditional ideas of power and territory.

Rather than seeking to join the EU, Russia now has regular summits with the powers-that-be in Brussels. There will be an EU-Russia summit on May 10th in Moscow, the day after the Victory Day celebrations. Mr Putin and the European Commission's José Manuel Barroso plan to sign lengthy agreements on trade, regulation and cultural and scientific exchanges, as well as on such concrete topics as airlines' rights to fly over Siberia.

Behind the friendly handshakes, though, the relationship between Russia and the EU is deteriorating. Lilia Shevtsova of the Carnegie Endowment in Moscow says that the Russian government is becoming “more and more suspicious” of the EU. The fact that the three Baltic states, once part of a Union run from Moscow, have just joined another headquartered in Brussels makes it seem as if the EU is gaining territory at Russia's expense. Fyodor Lukyanov, editor of *Russia in Global Affairs*, a magazine, thinks that the Russian leadership has concluded that “the European Union is just a new kind of empire”: one that threatens to continue to expand into Russia's historic sphere of influence. The Ukrainian revolution, and especially the role played by new members such as the Poles in supporting Ukraine's democrats, has stoked Russian fears of EU expansionism.

The EU has one powerful motive to try to maintain a decent working relationship with Mr Putin: growing dependence on Russian energy. The Russians are the world's second-largest oil exporter and its largest exporter of natural gas. Germany gets some 40% of its gas from Russia; western oil companies are excited by its large, untapped reserves. This vital economic tie is creating what one diplomat

acknowledges is a “Saudi-style relationship” between Russia and western Europe—rather as it did in the dying days of the Soviet Union. Whatever reservations they may have about political developments in today's Russia, the Europeans have a strong incentive to be tactful.

Divide and rule

Unfortunately, if typically, divisions exist within the EU over how indulgent to be to Mr Putin. The Poles and Balts remain deeply suspicious of a place that controlled them until 1989. But France and Germany are still keen to embrace the Russian president. The British are in the middle: keen on a good relationship with Russia, but alarmed by Mr Putin's anti-democratic instincts. The French and Germans counter British suggestions that the EU should tut-tut a bit louder with the argument that any successor to Mr Putin may be even less congenial. But their opponents within the EU detect other Franco-German motives. France's Jacques Chirac has been open about his desire for a multipolar world, to counter the dominance of the United States. He undoubtedly sees Russia as one of those poles, a point that became evident during the Iraq crisis, when the French, German and Russian leaders staged joint press conferences to oppose the war.

The splits within the EU over Iraq are a reminder of something else: that the future of its relationship with Russia depends not just on developments within Russia, but also on how the EU itself changes. A club that developed into a tight political union of the sort that France and Germany seem to dream of would find it very hard ever to accommodate Russia. The only question then would be whether the EU developed a friendly or an adversarial relationship with its giant eastern neighbour. But if the EU were to turn into a larger, looser organisation that easily included Ukraine and Turkey, then even Russia might yet find a place within it—one day.

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Politics

The strange tale of Tony Blair

May 5th 2005
From The Economist print edition

The Guardian

Tony Blair said he would transform British politics, and has done just that. So why is Britain disappointed with him?

AS THIS article went to press, Tony Blair's Labour Party was musing on its third successive election victory. During the campaign, politicians of all parties had conspired to persuade the electorate that the outcome was uncertain—Labour ones because they used the threat of a Conservative victory to get their supporters to the polls, Tories and Liberal Democrats because they needed hope to keep their campaigns alive. But a Labour victory was never really in doubt. The best the Tories ever hoped for was to reduce Labour's mighty majority—which they have.

Up to a point, a good result for the Tories. But that this should have been the limit of their ambitions was surprising, given that Mr Blair is no longer as popular as he was. Britain has not re-elected Labour with any enthusiasm. Like *The Economist*, it sees no clear alternative to Mr Blair, but it has come to wish there were one.

In 1998 this newspaper called Mr Blair “the strangest Tory ever sold” (see article). The years since then have done nothing to render that judgment incorrect. Mr Blair is no Thatcherite: be clear about that. But he is nonetheless a Tory, of the old-fashioned, pre-Thatcher, one-nation sort, superbly repackaged for the modern era. The fact that he presides over an electorally successful and substantially reconstructed Labour Party, a movement that still in its heart despises every species of Tory, is one of the things that make Mr Blair such a strange and fascinating politician.

The strangeness does not stop there. Mr Blair's eight years in office have won him extraordinary standing abroad, something which he plainly relishes. In America he is talked of reverently by Democrats and Republicans alike. In a country where politics has become ever more viciously polarised, it often seems that adoration of Mr Blair is the one thing the opposing tribes can agree on. Republicans love him for his unflinching support of America's assertive foreign policy; Democrats because they see a towering figure of the centre-left, a man with the magnetism and the energy of Bill Clinton, if not quite the brains—and, would you believe it, no bimbos. They rightly give Mr Blair the credit for reinventing the Labour Party and transforming its electoral prospects. If only, they tell themselves, we could find a leader like that.

Continental Europe's regard for Mr Blair is mostly cooler, as you would expect, yet there too he is

respected and, after a fashion, admired. Paradoxically (because he is uncomfortable with it) he gains a kind of strength from his country's instinctive Euroscepticism. He is viewed as expressing and representing a distinctive view of how the European Union should be run, and of Europe's place in the world, views that have gathered new support as the club has grown. His special friendship with the United States is acknowledged, albeit grudgingly. In Europe as in America, he is seen as a bridge across the Atlantic. In its own way, Europe is impressed by Mr Blair—and will be all the more now he has won a third election victory. What would Europe's other leaders not give for that kind of longevity in power?

Yet Britain's electorate is no longer so impressed. The politician who could once say, “Trust me”, or “I'm a pretty straight kinda guy”, and expect an indulgent response would no longer dare: today, the response would be derision. “Lack of trust” in the government has been the motif of this election campaign. According to the polls, most voters believe that Mr Blair lied to them about Iraq. His assurances about many other aspects of government policy have come to be heavily discounted as well. His perceived qualities of firm leadership and personal appeal still register strongly with voters, but when the prime minister says something, he can no longer expect to be believed. The loss is all the greater for a man who began by making honesty and straightforwardness, against the odds, such central elements of his political personality.

A remarkable sign of his diminished standing—and of the fact that Mr Blair and his party recognise it—is that the prime minister, still a comparatively young man, recently promised that this will be his last election. In British politics, this was an unprecedented declaration. Evidently it was judged to be a vote-winner.

How did Mr Blair come to fall so far in Britain's esteem—and why, incidentally, did that fall not guarantee a sweeping victory at this election for the Tories? Iraq is part of the answer to both questions. The war has seriously damaged Mr Blair; yet it gave no clear advantage to the Tories, since on the big decisions about Iraq, as they have said, they would have done the same. On the other hand, you could argue that Iraq was only an instance, though doubtless a very important one, of a larger perceived failure of the Blair project.

Across the board, the government stands accused of elevating presentation over substance and political expediency over principle: that is what the complaint about “lack of trust” really means. Mr Blair is not charged with an occasional lapse in this regard: many voters have come to see this pattern as his basic mode of operation. In some ways the accusation is no doubt unfair, yet it has stuck.

Before Labour came to power in 1997, Mr Blair might have hoped that the term Blairism would come to stand for a distinctive set of policies, as Thatcherism did and still does. Revealingly, the word has never been needed. There is no such thing as Blairism—and if there were, the term would far more likely denote spin and other dark political arts than policy.

Rex

Spinning in Iraq

Arguably, though, it had to be this way. When Mr Blair seized the leadership of the Labour Party in 1994, in a manoeuvre that left Gordon Brown, the chancellor, and his supporters cursing the new leader's ruthlessness, he set himself the task of making the party electable. This was not a universally popular ambition within the party. It was also a colossal task. Examine what Mr Blair did in the period that

followed, and you cannot question the man's vision or courage. Under his leadership, against the wishes of many and perhaps most of its members, the Labour Party was completely reinvented—and in a hurry, too. Mr Blair and his team were not shy about what they were doing. Just the opposite: they boasted about it.

This was not merely a dusted-down and smartened-up Labour Party, this was New Labour—to all intents and purposes, another party altogether. Shibboleths such as clause four (the party's absurd yet cherished commitment to take the whole economy into public ownership) were ritually torn down. These were fights Mr Blair chose to pick; he won every one. The changes were not superficial. They ripped the party up by its roots, and that was the idea. The trade unions, formerly the party's paymasters and the font of its old ideology, were appalled. Mr Blair loved it that they were appalled: what could be more pleasing to voters at large? His mission was to steal the party from its previous owners, and have it understood that that was what he had done. He succeeded.

Was New Labour really so different? Refresh your memory of the previous version by looking at John Prescott—the pantomime socialist thug conveniently retained by Mr Blair in the meaningless post of deputy prime minister to appease the old guard. Mr Prescott, virtually invisible during this campaign, was the party Mr Blair inherited. Ponder that, look at the party now, and see how far it has come.

But effecting this astounding transformation, and then securing that first electoral victory in 1997 (to which everything else came second), called for two more things. One was a ruthless world-class election-winning machine, capable of steering the press, shredding the Tories every time they opened their mouths and exerting ferocious discipline on the party's hitherto-wayward members and MPs. That fearsome machine was duly built. Britain had seen nothing like it.

The other requirement was a completely new programme for government—new to Labour, that is. This had to strike a very difficult balance. It had to be specific and detailed enough to allay suspicions that a party so long in opposition might be unprepared for government. It had to stifle concerns that New Labour would be as loose with public money as the old party. It had to recognise, silently, that many of the economic reforms of the Thatcher era had been both necessary and overdue; it had to promise, under its breath, that those reforms would not be reversed. And yet it had to convey to the party's core supporters, who deplored the Thatcher era and all its works, that New Labour was still worth voting for.

The two faces of Tony Blair

From its very conception, in other words, New Labour had two faces—and had to have. It presented one of them to the new supporters it needed to reach: voters who had elected four consecutive Conservative administrations, who were ready (to put it mildly) for a change, but who did not want to see the policies of those administrations simply reversed. The other face was shown to the party's members and traditional supporters: they might no longer be very clear about their socialist principles, but they knew that if they were anything, they were still anti-Tory. Happily for Mr Blair, many of these, even now, regard adopting soft Tory policies as a small price to pay for kicking the despised Conservatives out of power. At any rate, this was the unsteady coalition on which New Labour based its rule.

In a survey of “Britain's new politics” which appeared in *The Economist* in 1996, we argued that holding this peculiar coalition together, in such a way that neither side became so bitterly disappointed with Mr Blair's Labour Party that they chose to abandon it, would require the leadership of a political genius. The article also acknowledged the possibility that Mr Blair, who by that time had already stamped himself indelibly on British political history, might in fact be a political genius. Sure enough, though his coalition has come under strain from time to time, it has not yet—or so it appears—fallen apart.

Even recognising Mr Blair's talents, it must be noted that the Tories themselves deserve much of the credit. The memory of Britain's humiliating ejection from Europe's exchange-rate mechanism in 1992 is still vivid, neither forgotten nor forgiven: “Black Wednesday” destroyed the Tories' reputation for economic competence in the space of an hour, and more than ten years later the damage has not been repaired. Polls have consistently shown that Labour is regarded as a better steward of the economy. One particularly remarkable sign of this is a recent poll finding (YouGov in the *Daily Telegraph* of April 18th) that Britain believes the Tories would be about as likely to raise taxes after the election, were they to win it, as Labour. The Tories' greater desire to keep taxes low can hardly be in doubt: apparently, their competence on the point is what is questioned.

Labour, with luck on its side (and by 1997 with strongly improving public finances too, courtesy of the

Tories), has run the economy pretty well. To that end, its instant granting of control over interest rates to the Bank of England was a masterstroke. The Tories make a sad contrast. Even under the relatively competent leadership of Michael Howard, they have often seemed to be reeling still from the setbacks of more than a decade ago.

Be that as it may, New Labour came to power with an intellectually ambivalent programme, and relying on the support of an unruly and uncomfortable alliance of constituencies. As a result, its preoccupations with spin, with tyrannical centralised party discipline and with the need for a marked flexibility of political principle were not optional extras. New Labour could not have ground the Tories down so effectively without them. The problem for Mr Blair was that as these necessary methods of political control became more obtrusive—not least over Iraq—Britain grew disenchanted with them. The leader could no longer get away with his always disingenuous pose of “what you see is what you get.”

Groucho Marx once famously observed, “The secret of success is sincerity. Once you can fake that, you've got it made.” Mr Blair faked it too much, and got found out. But in a way, justice is served: now, even when he really is sincere, he is assumed to be faking it.

There is no evidence that Mr Blair ever “lied” about Iraq. That is true of the controversy over what was known about weapons of mass destruction, and it is also true of the most recent disclosures about the advice given to him about whether an attack on Iraq would conform to international law. In all likelihood Mr Blair believed, along with all the experts advising him, that Iraq did indeed have weapons of mass destruction. And most likely he also believed that Britain's interests and the greater good required him to support George Bush's plan to oust Saddam Hussein—and that a strong case for such action could be made in international law.

Phoney Tony

Yet Mr Blair was not, as he would put it, straight with the people, or with Parliament, or even with much of his own government, in stating these convictions. The real calculations, defensible as they may have been, were done by the prime minister's small circle of trusties and spin-doctors. The flow of information to the cabinet, to the wider civil service and to the public at large was controlled and manipulated not (or not only) according to the demands of national security, but mainly to smooth Mr Blair's political path. (This, remember, was a government that had promised a brave new openness and “transparency”.) Thus, for instance, the government evaded and denied the awkward truth that compliance with international law might forbid the course of action that was nonetheless, all things considered, in the country's best interests. Mr Blair, as always, hoped to have it both ways. And who can blame him? More often than not in the course of his career, he managed to do just that.

At home, the main awkward truth that needed to be brushed over was that New Labour was largely consolidating, albeit softening, the reforms of previous Tory administrations. Again, that policy was not wrong. It was most likely in Britain's best interests, and for New Labour it was anyway politically necessary. But for a man of Mr Blair's ambition and vanity, it was also embarrassing. He wanted to be regarded as a radical in his own right—a transformer of the country, in the mould of Margaret Thatcher, not merely of his own party. This inclined Mr Blair and his circle to a perpetual state of making a great fuss over nothing. What New Labour lacked in substance, it could make up for in public relations. And, to be sure, the team for that was in place.

Remember the “Third Way”? Probably not. That was New Labour's grand unified theory of the new politics—a distinct ideology, neither socialism nor neoliberalism, to explain how kindly 1970s-vintage Tory policies were really a fresh-minted response to the 21st-century challenges of globalisation, post-modern international relations, the end of history and so forth. The policies weren't bad, on the whole. The encompassing new ideology did not even survive the first term.

At the smaller scale, New Labour's hyper-energetic public-relations machine ensured that every fluctuation in policy was elaborately packaged and repackaged, launched and repeatedly relaunched, each time as an entirely new policy more radical than any previously conceived. Initiatives and their supporting documentation poured forth in a torrent. The method soon descended into self-parody. At some point, diminishing returns, so far as the public's perception was concerned, set in. Worse than generating mere boredom, the strategy of permanent policy revolution bred weariness and cynicism. Politically, it became counter-productive: often the government now finds itself getting less credit than it deserves for its innovations, such as they are.

In only one broad area of policy can the government claim to have been genuinely radical, in fact: constitutional reform. The government granted substantial devolution to Scotland, and recast the House of Lords. Unfortunately, the reform of the Lords was a debacle. Overturning the hereditary principle was both popular and right, but the government's consequently increased powers of patronage are a travesty of democratic propriety. In other areas of policy, there is often plenty to like, but rarely much that is really new—most good things (as in health and education) being variations of earlier Tory ideas, either retained, or belatedly rediscovered, or extended; and always, of course, the tiresome threadbare pretence that the policies are wholly New.

The strangest Tory over-sold

To a large extent, therefore, Britain is disappointed with Mr Blair and New Labour simply because it is tired of the party's remorseless, pathological, high-pressure salesmanship. Circumstances surrounding the party's rebirth decreed it had to be that way. And it need not subtract much, if anything, from history's verdict on Mr Blair. If he has succeeded, after all, in consolidating centrist politics within the Labour Party, and hence in the country, that will be something to be proud of. Has he? In all likelihood, yes—though it will take a full term of Labour in power under a different leader to be sure.

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Marconi

Frozen out

May 5th 2005
From The Economist print edition

Another British manufacturing firm is in trouble

IT HAS been a bad few weeks for the big names in British industry. MG Rover, the country's last big independent carmaker, went bust last month. On April 28th, BT, the country's biggest telecoms firm, announced the winners of the first set of contracts to help it build a whizzy new data network worth £10 billion. But one name was missing from the list: Marconi, Britain's last big producer of high-tech communications kit. The firm's share price fell 40% on the news, destroying all the gains made since it was relisted in 2003, following its collapse during the telecoms and dotcom crash (see chart).

That's because the deal, thought to be worth £500m-700m over ten years, was vital to Marconi's future. BT's new network will be the first of its kind in the world, and had Marconi's bid succeeded it would have been in a good position to sell its kit to other telecoms firms, who will be watching the project closely. Few industry watchers now believe that Marconi can survive as an independent company, although its existing contracts give it some time to ponder its fate.

In some ways, Marconi's troubles echo Rover's. The telecoms equipment industry, like the car industry, is dominated by giant firms which enjoy big economies of scale. Marconi was too small to compete. “This is something we've feared for a long time,” says Richard Windsor, an analyst with Nomura, a securities firm. “We were worried that, because Marconi is so small, it wouldn't be able to afford enough research and development. What actually happened was that they did the research but then couldn't compete on price.”

Another parallel with the Rover saga is the possibility of salvation from China. One surprise winner in BT's bidding war was Huawei, an ambitious Chinese firm. It already has links with Marconi, and Mr Windsor reckons that Marconi's intellectual-property portfolio would make it an attractive takeover target. And he thinks that Huawei would be interested in buying Marconi's researchers as well as its fancy technology.

In the short term, big job losses look likely. But there may be a silver lining. Stephen Hearnden of Intellect, an IT trade body, points out that many big telecoms firms do R&D in Britain. Skills are scarce, he says, and BT's new network will create more demand. Any sacked engineers and technicians are unlikely to be out of a job for very long.

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Economic prospects

Post-election blues

May 5th 2005
From The Economist print edition

The weak housing market is already slowing the economy

Get article background

LABOUR made much of its success in managing the economy during the campaign. If the election had been delayed a few months, the party might have found it difficult to advance such a convincing case. The short-term economic outlook is darkening.

One worry is an unexpected pick-up in inflation. Annual consumer-price inflation jumped from 1.6% in February to 1.9% in March. Though not high by historic standards, it was the highest in almost seven years and uncomfortably close to the government's target of 2%.

The upsurge in inflation will weigh heavily with the Bank of England's Monetary Policy Committee (MPC) when it makes its next decision on interest rates on May 9th. Already, worries about inflationary pressures have led two members of the nine-strong committee to back a rise in interest rates from 4.75% to 5.0%.

However, the MPC seeks to curb future rather than current inflation. This is because a rise in interest rates takes about a year to slow the economy and then another year for that slowdown to have its maximum impact in braking inflation. So the committee will have to take into account not just the higher starting-point for inflation but worries that growth prospects are deteriorating.

Rises in consumer spending, which accounts for some two-thirds of GDP, have underpinned economic growth in the past few years. But in the last three months of 2004, household consumption grew at a quarterly rate of just 0.2%. In the first quarter of 2005, retail sales, which make up a third of consumption, rose in real terms by only 0.3%. A survey by the Confederation of British Industry (CBI) reported the sharpest annual fall in retail sales in April for almost 13 years.

Consumers started to shun the shops after the housing market turned down in the second half of last year. House prices have essentially stalled in the past few months. As a result, the annual rate of house-price inflation has decelerated sharply. As recently as last July, it was running at 20.3% according to the Nationwide index, but by this April it had fallen to 7.0%, the lowest in four years.

House prices are cooling in response to a steep decline in activity in the housing market. In March, 91,000 mortgages were approved for house purchases, somewhat more than in February but a quarter fewer than a year before. Turnover is likely to stay sluggish as potential sellers who are unwilling to accept lower prices respond by taking their houses off the market.

Last year, the Bank of England suggested that the usual link between house prices and consumer spending had weakened in recent years. Household consumption had grown respectably but not spectacularly at a time when house prices had been soaring. However, the link with retail sales seems to be re-asserting itself as the housing market turns sour (see chart).

A consumer slowdown is not necessarily a bad thing provided that it is not too sharp and that other sources of demand such as exports and investment can take up the slack. However, neither of these conditions can be relied upon. The consumer slowdown has been abrupt. Export orders in the past three months were the most disappointing since autumn 2003, according to the CBI's industrial trends survey in April. Businesses are unlikely to make big investments as they start to worry about a slowing economy.

What this suggests is that the MPC is likely to keep interest rates at 4.75% on May 9th. Its decisions later this year will hinge upon whether the consumer shows more resilience to a weak housing market than has been the case in the past six months.

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Foxhunting

Tail-chasing

May 5th 2005
From The Economist print edition

This foxhunting season looked surprisingly similar to the last one

ENGLAND'S foxes are now safe from packs of baying hounds and their followers on horseback until the winter. Though a ban on hunting wild mammals with dogs did become law on February 18th, after several years of occasionally surreal wrangling over questions like whether a fox experiences fear, this is not the reason why the foxes can relax. Rather, it is because the hunting season is now over. So what difference did the ban actually make?

Not much, if the figures are to be believed. According to the Countryside Alliance, a lobby group, some 800 foxes were killed in about 1,000 days of hunting from February 19th until the end of the season. That's a normal number of days. Nobody has been charged under the act.

As with all the most bitter sectarian conflicts, though, the meaning of the facts is disputed. While a success rate of 0.8 foxes per hunt might sound like definitive proof that hunting is a spectacularly inefficient way to kill bushy-tailed canines, the Countryside Alliance reckons that this is a normal rate of return for the end of the season. It argues, therefore, that the new law has not saved any foxes. By contrast, the League Against Cruel Sports, another lobby group, thinks that hunts normally kill more foxes over a comparable period, and says that the ban is working well.

Disagreement over how authentic hunting has been since the ban is equally fierce. Opponents say that the law has spoiled the hunters' fun and that their sport will slowly die out. But the hunts say they have found ways to operate within the law. These include laying a false fox scent, which the riders then pursue. The perfume for this simulated hunting is made by boiling up a dead fox, by soaking one in water with a dash of paraffin, or from plain fox urine. If, in the course of a pretend hunt, a real fox appears, then the dogs can kill it, so long as the hunt did not set out intentionally to go after the real thing.

But such intentions are hard to prove. The diehard opponents of hunting have been spending their Saturdays sitting in hedgerows with video cameras and then sending the tapes to the police—without much success. Other legitimate forms of hunting include setting off after rats and accidentally catching something else (such as a mink), or using a pair of dogs to flush out an animal, which can then be shot. In fact, rather than sweeping away foxhunting, the new law appears merely to have added to the already extensive set of strange conventions that make the sport so colourful.

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Gay Muslims

Double trouble

May 5th 2005
From The Economist print edition

The personal and the political

PA

...or not

PUT 100-odd gay British Muslims in the same room and the talk is of secrecy. At their biggest-ever conference last weekend, most participants' conversations began with questions about coming out. Some had told their siblings but not their parents, or their mothers but not their fathers. Others had told their relatives in Britain but not those "back home" in the sub-continent. But almost nobody, it seemed, was "out" at their local mosque. "I want to be able to pray without distraction," explained one flamboyantly dressed self-described "Bollywood queen".

That's wise. The Muslim religious establishment is sternly opposed to homosexuality, which it sees as explicitly prohibited in Islam. That is anchored in the social and cultural traditions of most of Britain's Muslims, who come predominantly from rural regions of south Asia. One of Britain's most liberal-minded imams did turn up to the conference, and after a lengthy plea to have his anonymity preserved, said that the Koran explicitly condemns hatred and killing, not homosexuality. But he's unusual.

Intimidation, however, isn't. The conference took place at a secret location, protected by security guards. Although journalists were allowed, recording equipment was banned, as was the use of participants' names. Some Muslim organisations in Britain believe that the punishment for homosexuality is death. That's not an idle threat: Britain's best-known gay activist, Peter Tatchell, told the conference that six lesbian and gay Muslims had been murdered by Muslim vigilantes, and the crime "covered up by the community". He urged participants to raise their public profile. That prompted a sharp exchange with an intense young man who works for an organisation that supports what he calls "Jihadist" groups. Worrying about Muslim anti-gay prejudice would be a "luxury", he said: revealing his sexuality would distract his brothers from their struggle against the main threat, Islamophobia.

But most participants, who were mainly young, secular and middle-class, saw things differently. Their main preoccupations were personal and social: there were eager takers for literature about homosexuality to give to parents and family. There was a moving session where two Muslim mothers of gay children explained how their initial shock, fear and horror had gradually given way to acceptance and renewed love. Some participants, by contrast, said sadly that they had not seen their own parents for years.

Compared with a conference of gay Christians or gay Jews, other striking differences went beyond the anonymity and official disapproval. There were no outward signs of piety, for example. Only seven participants attended lunchtime prayers on the first day. That, said one foreign participant, was a feature of British gay Muslims: similar conferences in South Africa and North America had focused more on religion than on fear.

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Bagehot

Together again (for now)

May 5th 2005
From The Economist print edition

A four-week break from the office helped Tony and Gordon rediscover what they had lost. Will it last?

TONY BLAIR may have the most famous (and most irritating) grin in British politics, but during this election campaign, it is the image of the supposedly dour, often sullen chancellor wreathed in smiles that will stick in the memory.

It is not quite true, as some have suggested, that Gordon Brown has been the dominant figure of the campaign—that, for both good and ill, has been Mr Blair. What is not in doubt is that Mr Brown has emerged from the campaign politically stronger than ever before. Moreover, he has done so not at Mr Blair's expense, but by giving the prime minister the kind of unstinting support that has often been lacking during the past eight years.

Given their recent history, the transformation in the Blair-Brown relationship during the past four weeks has been remarkable. On the eve of the campaign, there was still uncertainty as to what role Mr Brown would play. He had been infuriated by Mr Blair's decision to stay in the job for a few more years, by the resurrection of an old enemy, Alan Milburn, to take charge of Labour's re-election strategy and by rumours that he would be forced to move to the Foreign Office. But the notion that he would be a peripheral, sulky figure during the campaign was always implausible. For all their differences, Mr Brown and Mr Blair both wanted Labour to get the largest majority possible.

Yet their willingness, once Labour's focus groups had revealed that pictures of them together provoked much greater enthusiasm than when they were on their own, to turn themselves into an unprecedented election double act was unexpected. For both men, it involved swallowing resentment and pride. For Mr Blair, it was an admission that he had been so tarnished by Iraq that Labour's chances of a third term might be jeopardised if he were the lone figurehead of the campaign. For Mr Brown, it was an acceptance that his own fate remained inextricably tied to that of Mr Blair. So determined are they both to hold on to power that what might seem impossible to normal people was, to them, fairly easy.

What followed initially provoked guffaws from political reporters who had spent years covering their

feuds. A party political broadcast directed by Anthony Minghella—a syrupy portrait of a political marriage in which they gazed into each other's eyes and chuckled over memories of old spats—seemed to invite ridicule. But only days later came the launch of Labour's manifesto at which Mr Brown talked enthusiastically about the part that private providers could play in offering choice in publicly funded health care. Even hardened cynics were taken aback.

From that point onwards, the two men were hardly ever seen out of each other's company, rushing to Birmingham to share the pain of the wretched Rover workers, pumping the flesh to get the vote out in marginal constituencies, and appearing in countless photo opportunities and press conferences. When, at the end of last week, the attorney-general's advice on the legality of the war was leaked to newspapers and journalists scented blood, the chancellor interposed his body between Mr Blair and the media pack. The prime minister, said Mr Brown, had not only behaved entirely properly in the run-up to war, but he would have done exactly the same thing. Turning up to be interviewed by Sir David Frost last Sunday, Mr Blair said chirpily: "I'm on my own this morning."

It isn't just the ruthless professionalism of a couple of seasoned politicians. There's more to it than that. The body language has become increasingly relaxed; their tributes to each other are no longer paid through gritted teeth. Thrown together by necessity during the campaign, they started talking to each other in a way they had not for more than a decade and rediscovered, to their surprise, something close to mutual admiration. What nobody knows, including them, is whether their rapprochement will survive after May 6th.

A test for Mr Brown

Hopes that it may rest on two assumptions. The first is that Mr Brown no longer wants to cast himself as the drag anchor on public-service reform. That may be because his old opposition was driven less by ideology than by the need to find differences with his former friend. It may also be because policies he was once sceptical about are beginning to work: the English NHS, for instance, is performing better than the unreformed versions in Scotland and Wales. Mr Brown's allies maintain that it is nonsense to suggest he has been anti-reform: what irked the chancellor was the self-consciously confrontational way in which Mr Blair set about it. Mr Brown, they say, is happy with both the distinctly New Labour manifesto and the departmental five-year plans that preceded it.

The second assumption is that Mr Brown is reconciled to allowing Mr Blair to carry on for another three years, should he wish to do so, without staging a repeat of the kind of power play that he and his followers mounted about a year ago. In the past few weeks, Mr Blair has as good as anointed Mr Brown as his chosen successor; it is also quite possible that he will quit sooner, especially if the government holds and loses a referendum on the European constitution. For his part, Mr Brown would like nothing better than a smooth transition that would remove the risk of the bitterness that still poisons the Tory party 15 years after Margaret Thatcher was forced out as leader.

It could, however, just as easily turn sour. Mr Brown's self-styled supporters, many of them restless and disaffected, some of them fundamentally hostile to New Labour, have caused plenty of trouble in the past between the prime minister and the chancellor and yearn to see the back of Mr Blair. The future, not just for the Blair-Brown relationship, but also for Labour's ability to win power, may well depend on how determined Mr Brown is to rein them in.

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Has he got the ticker?

May 5th 2005
From The Economist print edition

AP

Australia's economic performance has been the envy of western countries for well over a decade. But, says Christopher Lockwood (interviewed here), the country now needs a new wave of reform to keep going

Get article background

THE best-loved character in Australian folklore is the “battler”, the indomitable little guy who soldiers on despite all the odds, struggling to hold down his job, raise his family and pay off his mortgage. Battling adversity, after all, is what Australians excel at—and have done since 1788, when the first convicts were disgorged on to that fatal shore to build their own prison. Not for nothing is Gallipoli, a catastrophic failure redeemed by a heroic evacuation, Australia's most celebrated military engagement, marked by a public holiday. The battler spirit has enabled Australians to survive and prosper in the driest inhabited continent on earth, full of the most poisonous snakes, the largest crocodiles and the most terrifying sea-creatures. John Howard, who last October was elected prime minister for the fourth time, has made one of the most successful political careers of modern times anywhere by appealing to those ordinary battlers.

The battler spirit has its good points and its bad. At its best, it has enabled Australia to undertake wrenching reforms when they were most needed—as in the 1980s, when the then treasurer (finance minister), Paul Keating, said Australia was on the way to becoming a banana republic. At the time, Mr Keating and his boss, Bob Hawke, were able not just to implement, but to win re-election on, policies that were as brutal as they were necessary. It was under this remarkable Labor team that the really tough things were done: the near-elimination of tariffs, the floating of the exchange rate, the first moves towards enterprise-level rather than industry-wide pay bargaining that was to break the power of Australia's unions; not to mention bank deregulation and the introduction of compulsory saving for pensions.

The Labor reforms have transformed Australia, making it a model of revival for the world. The Liberal Party too, then in opposition, deserves credit for supporting them, because Labor lacked a majority in the Senate. The result has been an economy that is about to enter its 15th successive year of continuous growth. It also enjoys low inflation, the lowest unemployment for almost 30 years, negligible government debt and regular budget surpluses. Australia has shrugged off its main trading partners' crises—Asia's

financial meltdown of 1997-98, Japan's decade of stagnation, America's tech-stocks crash—with scarcely a backward glance.

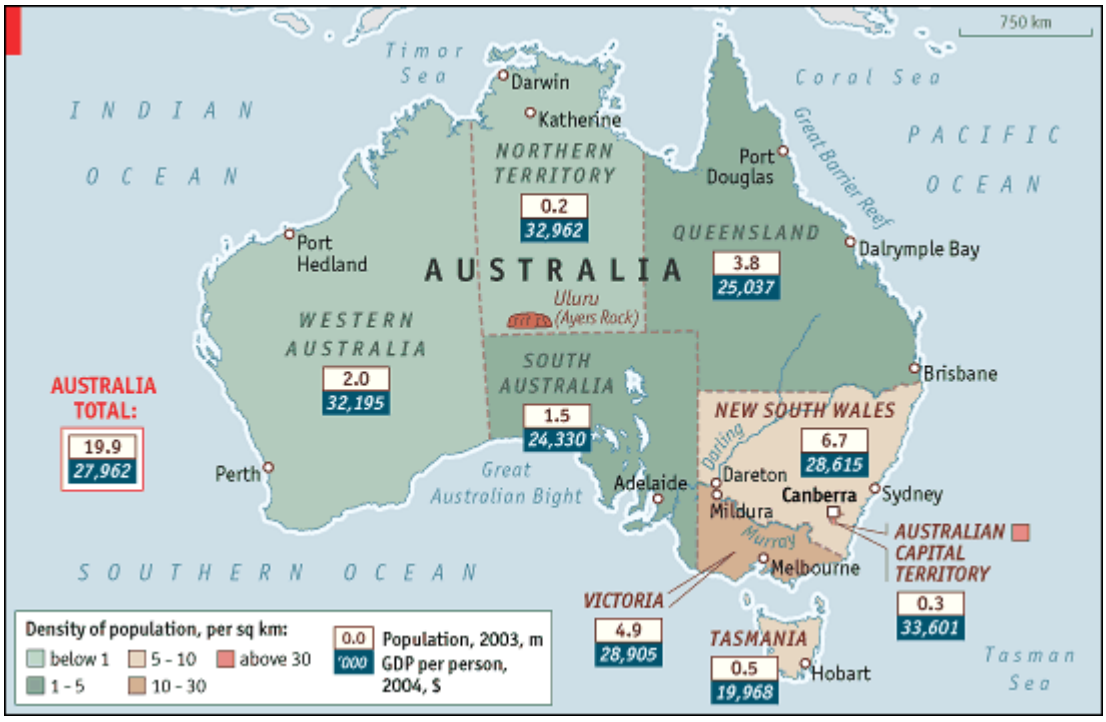
However, the qualities that have served Australia so admirably when times were tough are less useful in periods of prosperity. In 1901, when Australia became an independent federation, it was, in terms of income per person at purchasing-power parity, the richest country on the planet, thanks to abundant minerals and innumerable sheep. But it became complacent. By the 1950s it had dropped back to 6th place, and by 1990 to 18th—though it has since climbed back to 8th, thanks to two decades of reform.

But for most of Mr Howard's nine years in office, productivity-boosting reform has been on the back burner. “There has been a degree of reform fatigue,” says Michael Keating, a former head of the civil service who is now at the Australian National University in Canberra. “There is not the same sense of crisis that existed in the 1980s.”

In fairness, the toughest measures were already in place when he took office, and Mr Howard does have a few reforms of his own to boast of. The biggest was probably the granting of full independence to Australia's central bank in 1996, and the bank has discharged its inflation-controlling mission admirably and sometimes bravely. Mr Howard and his treasurer, Peter Costello, have run a tight ship, virtually eliminating national debt with a succession of budget surpluses. But their most visible reform, the introduction of a 10% value-added tax, has not been a wholly happy experience. To get it approved, they had to offer too many exemptions.

Still, Mr Howard has other things besides economic reform to his credit. In the past few years, his government has done a sterling job on its diplomatic and trade relations. One result has been that Australia is now the only major economy to have a bilateral free-trade agreement with America while also actively discussing one with China. In the late 1990s, Mr Howard adroitly saw off a xenophobic challenge from Pauline Hanson's One Nation party. As one of the most multicultural societies on earth, Australia enjoys excellent race relations, and Mr Howard has quietly raised immigration to impressive levels. By providing sensible subsidies for private health insurance, he has brought down the cost of the health service.

Besides, the lull in productivity-boosting reforms was not wholly his fault. Throughout his first three terms, his coalition, made up of the Liberals and the smaller National Party, was hampered by its lack of a majority in the Senate, the upper house of Parliament. This meant that much of what the government wanted to do—reform Australia's archaic system of industrial relations, privatise Telstra, its telecoms monopolist, change its media laws—was blocked, abandoned or never even started.

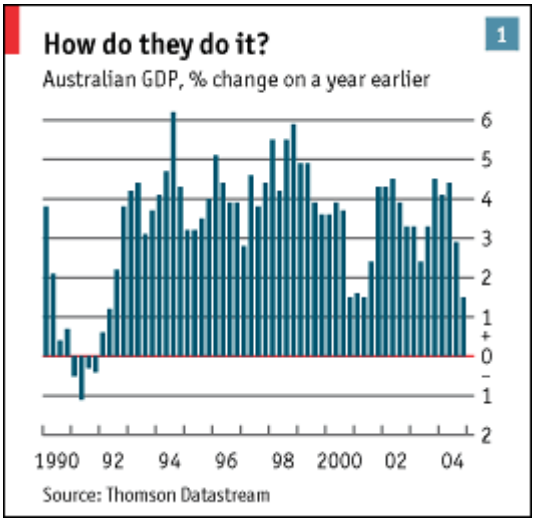


Crunch time

The fact remains that a second wave of reform is now urgently needed. The Australian economy is bumping up against supply-side limits. In February, Ian Macfarlane, the governor of the central bank, said the country had to get used to growth rates beginning with a two or a three, rather than the three or four that has been the norm for the past decade or so. He was promptly proved insufficiently pessimistic when the figures for 2004 were published, showing that GDP growth in the last quarter had slowed to 1.5% on a year earlier and to a dismal 0.1% on the previous quarter. Sober voices such as the OECD, as well as more excitable ones from the opposition, blame this on labour shortages, infrastructure bottlenecks and lack of training.

One outcome has been a ballooning current-account deficit. In March, it hit 7.1% of GDP, nearly a percentage point more than it was when Mr Keating was put in mind of banana republics. Chris Richardson, director of Access Economics, an influential think-tank based in Canberra, puts it bluntly. “We have failed at managing prosperity,” he concludes. John Edwards, chief economist at HSBC in Sydney, agrees. “We didn't believe our luck,” he says. “We have failed to invest sufficiently to sustain the upswing.”

But now there is a chance for change. At last October's general election, Mr Howard's coalition gained control of the Senate, though because of the oddities of Australia's constitution the change does not take effect until July 1st. But on that date, for the first time since 1981, Australia's prime minister will command a majority in both houses of Parliament. The list of what needs doing is a long one: more labour-market reform, more tax reform, more investment in people and infrastructure, and better relations between the federal government and Australia's six states and two territories, all Labor-controlled.



None of it will be easy, but for Mr Howard it is a sweet opportunity. In the early 1980s, when he served as treasurer in the government of Malcolm Fraser, he was convinced of the need for radical reform, but could never persuade his boss to agree. In opposition for 13 long years, he had to watch as the bold Mr Keating won himself renown (if not affection) as “the world's greatest treasurer”. Now, finally, he has the mandate he has always lacked.

In 1998, Mr Howard devastated the hopes of his Labor opponent, Kim Beazley, when he wondered aloud, on radio, whether he had “the ticker” for the job. He was calling into question Mr Beazley's political toughness, and perhaps even taking a dig at his less-than-trim appearance. Mr Howard duly won his second election. Mr Beazley resigned as leader after a third Howard victory, in 2001, but four years on he is back in charge of Labor. Mr Howard has proved a good manager and a skilled political tactician but not yet a great reformer. The interesting question now is this: has Mr Howard got the ticker?

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The limits to growth

May 5th 2005
From The Economist print edition

Newspix

Australia's constraints are all on the supply side. They need to be tackled

YOU can see it best from the air. At Dalrymple Bay in Queensland (above), on any given day recently, more than 40 huge ships have been lining up waiting to take on coal. Australia has plenty of the stuff, and China's demand for it is so voracious that this year's contracts are being signed at prices 70% higher than last year's. But the infrastructure—not the mines, but the rail links to the port and the loader itself—cannot keep pace. That is one reason why Australia's exports have stagnated, even though its terms of trade (the ratio of export to import prices) are more favourable than at any time since the 1970s.

Dalrymple Bay is the most obvious bottleneck, but there are plenty of other examples of supply-side constraints. Reserves of surplus capacity have been exhausted by growth. Congestion at ports and on rail networks is only part of it: figures from the National Australia Bank show that capacity utilisation in manufacturing industry is at its highest level for 15 years. Most serious, because slowest to rectify, is a shortage of skilled and even not-so-skilled people. Australia's unemployment rate has fallen to 5.1%, which the OECD regards as being close to rock bottom in an advanced economy.

Chip Goodyear, chief executive of Australia's largest company, BHP Billiton, says that among his biggest headaches is finding enough qualified engineers to run his mines; he would like to recruit in China and India, if the government will let him. This is particularly remarkable given that mining, these days, is more than ever a capital- rather than labour-intensive business. A shocking proportion of the fruit crop in the state of Victoria is left to rot because there are not enough fruit pickers. The central bank points to labour shortages in industries ranging from construction and engineering to accounting and IT.

These bottlenecks are taking their toll on productivity, until recently Australia's most impressive statistic. Throughout the 1990s, and into this decade, labour productivity (the amount of output per hour worked) grew at more than 2% a year, among the highest rates in the OECD and much better than America's (see chart 2). America is still significantly more productive than Australia, mostly because it uses far more information technology, but the gap has been slowly closing. However, there are now signs that Australia's productivity growth is slowing.

Small wonder, then, that as the date when the government will take control of the Senate approaches, business-backed and free-market lobby groups are scurrying to publish their wish-lists. The fourth Howard term, they reckon, marks a historic

opportunity to do things that no previous government has had both the will and the means to tackle.

Axing awards

Top of everyone's list is Australia's labour market. Australia long ago evolved a highly idiosyncratic system of industrial relations in which, for great swathes of the economy, not just detailed pay scales, but hours of work, tea breaks, holidays, sick pay and many other conditions—in all, a breathtaking list of 20 "allowable areas"—are centrally determined.

This is done through a system of "awards", sets of rules each covering a specific industry or sometimes a business. There are about 2,200 federal awards, granted by a hugely powerful tribunal called the Australian Industrial Relations Commission (AIRC), plus another 2,000 granted by five of Australia's six states. (The state of Victoria has ceded its powers in this area to the federal government.) This means that a big employer may have to deal with no fewer than six different, and sometimes inconsistent, industrial-relations jurisdictions.

There is no escape. The state of Queensland's website, for example, lists awards for bagmakers, beauty therapists and workers in butter and cheese factories, along with 293 others. The national "Session Singers (Backing Vocals on Records) Award" does not just spell out pay and conditions in minute detail, it even specifies the time of night when the singer must be put into a taxi home.

It is true that the awards system these days affects only about 20% of workers: a far bigger share (36%) are covered by a more familiar system called enterprise bargaining, brought in under Bob Hawke's government in the 1980s and extended under Mr Howard. But the long arm of the AIRC reaches here too: it has to certify that any such agreement passes a "no disadvantage" test, meaning that the terms and conditions are no worse than if there were no agreement.

A similar test applies to one of the Howard government's most trumpeted achievements, the introduction of Australian Workplace Agreements (AWAs), individual contracts between an employer and a single employee. The great advantage of AWAs, and to a lesser extent of enterprise bargaining, is that they provide for much more specific linkages between productivity and pay. The government says the results have been excellent, for employees as well as employers. The average weekly pay for workers on AWAs is about 35% higher than for workers on collective agreements. AWAs cover only 2-3% of the workforce, but have a much bigger effect than their numbers suggest because they influence enterprise bargaining.

One effect of all this is that Australia's minimum wage, at A$467 ($365) a week, is among the highest in the world. Moreover, the minimum wage is revised upwards annually by an unelected committee.

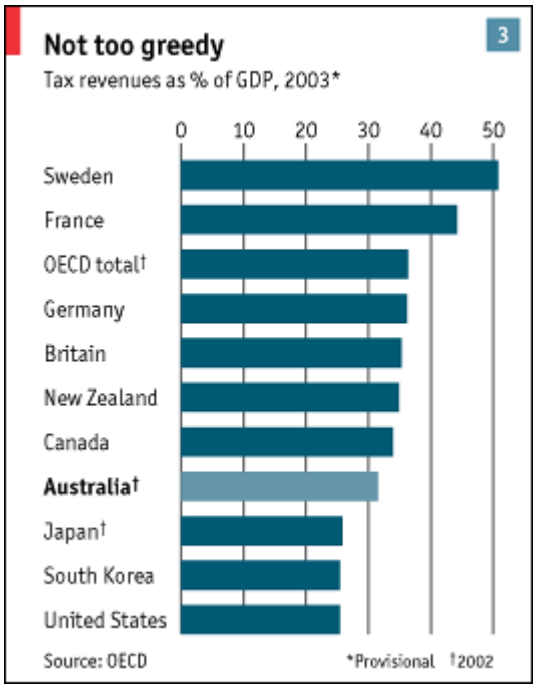
Industrial relations was the one area of reform in which the Hawke-Keating Labor governments pulled their punches because of their union connections. Mr Howard has been held back by his lack of a Senate majority. In an ideal world, he would now take an axe to what remains of a ludicrously complicated system, scrapping awards and the AIRC, though perhaps retaining a single national minimum wage, set by Parliament at a much lower level than the present one, and some basic national rules on holidays, maternity leave and the rights of part-timers.

In practice, though, not even the flintiest employers are advocating this. In Australia, notions of "mateship" and the "fair go" are still strong, and the prime minister is wary of following the American model too closely. But employers want to see the number of "allowable areas" in awards slashed to perhaps six; the AIRC stripped of its role as an arbitrator; an end to the "no disadvantage" test; and a single, unified federal industrial-relations system put in place. Other items on the wish-list include hacking away at the rules that make it hard to sack unsatisfactory staff. Mr Costello, the treasurer, says this has been blocked in the Senate no fewer than 41 times. Phillip Ruthven, chairman of IBIS, a Melbourne forecasting and business-information group, and a refreshing optimist, sees radical industrial-relations reform as, above all, liberating for the individual worker.

Taxing questions

Next on the wish-list is tax. Australia is widely seen as a low-tax economy, with the federal government taking around 21% of GDP and the various state, territorial and municipal governments another 10% on top of that through value-added tax and local imposts such as property taxes and stamp duties. That, indeed, is well beneath the OECD average of around 36% (see chart 3).

But, argues Peter Burn in a paper for the Centre for Independent Studies (CIS), a free-market think-tank, the figures are misleading. The OECD average is unweighted, meaning that low-tax America counts for the same as high-tax Luxembourg. If the average were to be weighted by GDP, Australia's tax rate would come out slightly above it. Taxation in Europe may be higher, but Australia is, in fact, a relatively high-tax economy compared with those of its principal markets, in Asia and America. And during the Howard years the tax take has gone up slightly, not down.



Worse than the level of tax, though, is the way in which it is levied. Australia's top rate of income tax is 48.5%, kicking in at only A$70,000, about 1.4 times average full-time earnings. The threshold is being raised to A$80,000 in July, but that will ease the burden only slightly. In America, by contrast, the top rate kicks in only on incomes of 12.5 times average earnings. Australian employers are pushing hard for a less incentive-eroding tax structure, but seem unlikely to get their way. Voting is compulsory, so Liberal politicians do not have to worry about getting their natural supporters to the polls, but instead concentrate on swing voters—most of whom are not top-rate taxpayers.

Reform at the other end of the scale is a better bet. Australia's generous system of benefits, coupled with relatively high tax levels at the bottom end, mean that people on low incomes can easily face an effective marginal tax rate of 60% or even more. Peter Saunders, of the CIS, gives the example of a single parent with two children who would find that, with a part-time job paying A$24,000 a year, 74 cents of each extra dollar earned would disappear in taxes and lost benefit. A family with two children and a single earner on average pay faces an effective marginal tax rate of 61%, one of the highest figures in the OECD.

It is not, the prime minister explains, an easy problem to solve, because the two simple solutions—ending means-testing for benefits or scrapping benefits altogether—both have severe disadvantages. But improved benefit-tapers would help; and there is a sound economic argument for not means-testing some benefits (child benefit, for example) at all. Australia also needs to reform its generous disability payments, which are out of control: over the past 20 years the proportion of adults receiving the benefits has more than doubled, with much of the increase attributable to “bad backs”.

One further tax reform that Mr Howard could deliver is the ending of an over-generous giveaway to the middle classes: the taxation of capital gains on assets held for at least a year at the low rate of 24.25%. Not only does this encourage all sorts of creative accounting, but it has also helped pump up a troublesome property bubble (see article).

So far the government has given little indication of how much, if any, of this it is likely to tackle. But interestingly for a party whose discipline over the past decade has been legendary, the Liberals now face dissent in their own ranks. A “ginger group” of around 30 mostly young Liberal MPs is pushing for sweeping tax cuts.

Inferior infrastructure

Taxes and industrial relations are areas where the left and the right are never likely to agree: but in the area of investment, the government's Labor critics and its natural supporters in business have formed common cause in condemning Mr Howard's record. In evidence, both camps cite a sheaf of recent reports pointing to various bottlenecks and shortages, from the OECD, the IMF and Australia's own central bank.

Naturally, they disagree on what to do about it. For Labor, the solution is relatively simple: spend more.

The cautious Mr Costello's obsession with running a constant budget surplus is seen as a wasted opportunity. Limited borrowing for investment purposes would indeed have been perfectly reasonable, especially given that government debt amounts to only 2.3% of GDP, compared with an OECD average of around 45%.

Businessmen such as the redoubtable union-busting Chris Corrigan, head of Patrick Corporation, disagree. The private sector can handle all of Australia's infrastructure needs, he reckons, if only government would get out of its way. He should know: he is trying to build a A$3 billion inland railway, connecting Melbourne to Brisbane, with a spur to Sydney, and his biggest problems are regulatory, not financial.

Chip Goodyear of BHP Billiton is in the same camp. His company has no real infrastructure problems because for the most part it has built its own railway lines to connect its mines with port facilities it also owns. Dalrymple Bay, which is fed by state-owned railways, may be congested, but Port Hedland, in western Australia, certainly is not. The private sector, he reckons, is better at planning for the future than is the public sector.

But even if the Howard government gets much better at tackling its infrastructure problems, there is one constraint it can do little about. Australia is a federal state, and most such decisions are made not by the federal government but by those of the six states (New South Wales, Victoria, Queensland, South Australia, Western Australia and Tasmania) and the two territories (the Northern Territory and the Australian Capital Territory, around Canberra). All eight are Labor-controlled, and all have shown more interest in delivering services such as health and education than in infrastructure investment.

Besides, a really big project, involving several state governments as well as the federal and any number of local ones, is sure to be a regulatory nightmare. Things are not as bad as they used to be: it took a century for Australia's states to adopt the same railway gauge, and the rules for road haulage have only fairly recently been unified. But many people believe that Australia has one layer of government too many. The states guard their powers too jealously and have frosty relations with the centre.

The same caveats apply to another of the supply-side constraints on Australia's economy: education. Australia's educational indicators are good, but not great. Participation in non-compulsory education is below the OECD average, and drop-out rates at universities are an appallingly wasteful 40%.

One reason is that Australia's public schools are not well run. The money for them comes mostly from the central government, but they are administered by state governments. Their curricula are rigidly laid down by state governments, and schools are among the last bastions of union influence in Australia: headteachers have few powers of discipline.

According to Brendan Nelson, the education minister and a rising star in the Liberal Party, the federal government is now concentrating its efforts on training, on which he thinks the states have done poorly. He is scathing about the states-run TAFEs (Technical and Further Education colleges)—places where, he says, people go to learn party management and belly-dancing, whereas the number of places for would-be car engineers has been cut. The federal government is setting up 24 technical colleges in competition with the TAFEs which will concentrate on trades, mainly different kinds of engineering.

The new colleges may shake things up a bit, but there is an endemic lack of competition in Australia's educational system. Bob Carr, the premier of New South Wales, says that, as a matter of policy, the performance of public schools in his state is not published. This means that parents find it hard to make rational choices—unless they choose to go private, which a third of them now do. Competition is also lacking at the university level, which is the responsibility of the federal government. Although universities have been given limited freedom to set their own fees, they remain tightly controlled by Canberra bureaucrats: the number of places they may offer in every discipline is set centrally.

There is room for more competition in many other areas too. Paul Keating, the former prime minister, who did more than anyone to open up Australia to competition, claims that the Liberal government “likes business, but it does not like competition.” Thanks to tariff cuts to almost nothing, large chunks of the Australian economy are now fiercely competitive. But there are still too many protected sectors, including newsagents, the legal profession, most public services, health insurance, pharmacies and international aviation, where significant barriers to entry remain. Cracking some of these open would yield valuable supply-side benefits—and help keep a remarkable success story rolling.

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Beyond lucky

May 5th 2005
From The Economist print edition

The economy has a lot more going for it than mineral resources

MOST people know three things about Australia, and all of them are wrong. They think it is vast, remote and lucky—as in “the lucky country”, meaning blessed with natural resources and therefore in fact “unlucky”, because resources diminish the incentive to specialise in less capricious sources of wealth.

But Australia's true strengths are quite the opposite. It is in fact a highly urbanised and even compact country, with over half of its population living in just five cities, and almost 85% living in towns. It may be impossibly remote from Europe, but it is well connected to Asia. With freight charges amounting to as much as 50% of the delivered cost of mineral commodities, that relative proximity gives it an advantage over rivals in, say, Latin America. A consignment of iron ore from Brazil takes twice as long to reach Shanghai as from Australia. And lastly, far from being (un)lucky in having lots of commodities, Australia's is an economy based overwhelmingly on services, which make up close to 80% of output, more than almost anywhere else. Tourism alone (see article) accounts for 5% of GDP, about the same as all of mining put together.

Still, minerals do matter. They are eminently fungible products (a tonne of ore is a tonne of ore) and have proved easy to divert from weakening markets (such as Japan) to rising ones (such as China). So they have played a big part in helping Australia adapt as, one after the other but not all at the same time, its various markets have gone through difficulties. And, thanks mainly to China's insatiable appetite for them, prices have recently been at record levels, lessening a nasty balance-of-payments problem. The big mining companies, BHP Billiton, Rio Tinto and Woodside, have turned in thumping results that have pushed the stockmarket to new highs this year. Next year's results could be just as good, given the stunning rises in contract prices now being negotiated. But the year after? High prices are driving big capacity increases everywhere, not just in Australia, so price falls may not be far behind.

As for remoteness, it is all a question of perspective. “Remote” Australia is rapidly turning itself into a regional hub for all sorts of businesses. Foreign direct investment (FDI) has been flooding in, thanks to a robust legal system, transparent and effective government and a multilingual workforce strong in IT skills and finance. The government claims that last year (admittedly an exceptional one) Australia chalked up an astonishing A$57 billion ($42 billion) in FDI, which compares impressively with the $60 billion that went to China, with 65 times as many people.

Much of this money has been chasing Australia's mineral assets, but much, too, has been aimed at the service sector. One in four Australians was born outside Australia, and these days those outsiders come from a bewildering (but increasingly Asian) array of countries, making Australia by far the most polyglot country in the region. According to Gary Draffin, head of Invest Australia, a government agency, that is one reason why Air France runs its Asian sales operation out of Australia, even though it has no direct flights to the country yet. American Express has based its Asia regional operations centre in Australia, and Deutsche Bank uses Sydney and London as its two global hubs for processing foreign-exchange transactions. Mr Draffin quotes the World Bank, which says that Australia is about the easiest country in the world to start a business, with regulatory procedures taking only two days, and the World Competitiveness Yearbook, which judges Australia the best place in the Asia-Pacific region for patent and copyright protection and the second best for transparency in government policy. It is also a remarkably IT-savvy place, for which the government, a world leader in e-government, can claim much credit.

Softly, softly

Two other reasons to be optimistic are that Australia now appears to have a good chance of avoiding the twin evils of recession and inflation as its economy starts to tighten; and that it has not, so far at least, suffered the property-price crash that many people feared.

Property prices have been a worry, though. Over the first four years of this decade, the main indices showed house prices rising by close to 100%, thanks to an extraordinary and potentially dangerous borrowing binge. Globally low interest rates have been a prime cause, but Australian politicians have stoked the fire with their own unwise decisions.

One, in 1999, was to cut the rate of capital-gains tax to 24.25%. This marked the beginning of an Australian love affair with owning a second home. A contributory cause was a practice called “negative gearing”, under which the entire cost of a mortgage on a rental property can be offset against the owner's income—not just from that asset, but from any source. Nor does the property actually have to be rented out: it need only be “available for rental”, so if the owner sets the rent high enough, he gets a holiday home with half his mortgage paid for by the taxman. Generous depreciation allowances and grants for first homes have also helped to push up house-price inflation.

Along with the property boom has gone a sharp rise in household debt. Measured as a proportion of disposable income, this has doubled over the past decade to over 160% (see chart 4). On the other hand, the debt is well covered: gross household wealth is eight times income, twice what it used to be. But, with two-thirds of household wealth now held in the form of property, against a third in shares and other financial assets, the housing market can have a big effect on the Australian economy, for good or ill.

Property prices appear to have peaked at the end of 2003 and may have dropped slightly in 2004, although such averages conceal big differences between different kinds of property. A further decline is possible this year, especially after a rise in interest rates in March. But there is certainly no sign of a free fall. And despite more than a year of soft house prices, consumption has held up pretty well. It looks as though the central bank, which raised interest rates twice in 2003 but not at all in 2004, has managed delicately to deflate the bubble without causing a crash.

The early bird

But what of the wider economy? “We have arrived at an interesting and delicate time in our business cycle,” says Saul Eslake of ANZ. Every recession in Australia's post-war history has started at precisely this point, he explains: when the economy is stretched as tight as a drum, and when two mistakes are typically made. The first is to neglect to rein in inflation before it can take hold; and the second is to over-react to it once it appears. The result is high inflation or a severe recession, or possibly both.

Perhaps the greatest single achievement of the Howard government was to grant the central bank full independence in 1996, so it no longer needed the treasurer's agreement for any interest-rate changes. Under Ian Macfarlane, who has been governor since that year, the bank has not been afraid to use this power, even when the government has strenuously objected. A quarter-point increase in March this year was textbook stuff: a small rise now to avoid a larger one later. But politicians would not have dared do it at a time when the economy is visibly slowing.

Most economists reckon that Australia's boom still has some way to run. Mineral companies are falling over themselves to add more capacity, and reforms after July 1st should provide at least some supply-side boost. And apart from the housing market, most economic indicators still look healthy. The corporate sector is in especially good shape. Profits as a proportion of GDP are at a 50-year high, and so is business investment, which is running at 14.2% of GDP. Unlike households, businesses have used the fat years to pay down debt, so if further rises in interest rates are needed, they will do little to hurt employment. Australia is in good shape to weather a period of lower growth.

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Infinite variety

May 5th 2005
From The Economist print edition

A beautiful empty country full of tourist attractions

TWENTY metres below the surface of the Pacific is a good place to reflect on the majesty of Australia's natural blessings. The Great Barrier Reef must surely rank among the world's natural wonders. Along the hundreds of miles of its coral expanse, even a dilettante diver with but a day to spend recently encountered reef sharks, schools of barracuda, friendly giant cod, turtles, manta rays, strange jellyfish (some deadly) and myriads of smaller iridescent fish of many different kinds. Scaremongers have often shrilled that the reef is dying, a result of agricultural run-off from the over-farmed Queensland coast. In truth, the preservation of the reef is something of a success story, a combination of active government intervention and the beneficial effects of responsible tourism.

“It used to be deemed that tourism was the enemy,” says John Rumney, manager of the *Undersea Explorer*, a ship that combines eco-tourism with scientific research. “But tourism has given people an incentive to preserve the reef.” These days, a third of the reef is protected, meaning that fishing and collecting coral and shells are completely banned. That protected part is now becoming an extensive nursery for fish-breeding, helping to restock the entire reef. “It makes sense,” Mr Rumney says. “Perhaps as much as A$4 billion ($3 billion) of the tourist industry is reef-related. Why would you jeopardise that for the sake of A$350m of fishing? A big cod is worth far more alive than dead.”

Boat operators are helping out in a hands-on way. The most serious threat to the reef is not agricultural run-off (which warms the water and increases its nutrient level, so that the coral gets choked by algae and dies), but a nasty starfish called the crown of thorns, originally imported in the ballast tanks of foreign vessels, which devours coral polyps. At least one big diving operator, the *Quicksilver*, has hired divers to collect the offender.

Not everyone comes to Australia to dive the reef, but even for landlubbers the Queensland coast has much to offer. The Daintree national park is one of the world's finest rain forests. Sun-lovers will find mile after mile of deserted beach. Port Douglas, the departure point for both the reef and the Daintree, is a lively resort town with excellent eateries. And that is just one part of one Australian state. From Uluru to the ancient Tasmanian forests, from Sydney (surely one of the world's coolest cities) to the magnificent winelands of the south and west, Australia is a remarkable place for a holiday.

No surprise, then, that tourism generates over 10% of Australia's export revenues and directly employs 500,000 people (as well as many more indirectly). Despite the “tyranny of distance”, in the phrase coined by the Australian historian Geoffrey Blainey to capture Australia's isolation, tourism is one of the country's fastest-growing industries. And new sources of visitors are still opening up: last year about 250,000 came from China, nearly 50% more than the year before. Once again, Australia seems to have struck it lucky.

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The reluctant deputy sheriff

May 5th 2005
From The Economist print edition

Australia's skilful foreign policy has made it many friends. Keeping them all happy will not be easy

ON TWO successive days in October 2003, Australia's two houses of Parliament met in joint session to hear first President George Bush and then President Hu Jintao of China. Though many Australians, and not just of the left, found it hard to decide whether it was the warmonger or the tyrant whose presence they found more objectionable, the visits proved one point: Australia has become a country of disproportionate consequence in world affairs. It has achieved the unlikely feat of close friendships with both the world's most powerful state and its most populous one, friendships that are being turned into hard cash. Last year Australia signed a free-trade agreement with America; in April it opened negotiations on one with China. These days, Alexander Downer, Australia's effective if prickly foreign minister, can plausibly say that “there is no need to trade off America against Asia”: Australia has managed to have both.

This has not, however, been easy or straightforward. After John Howard took office in 1996, Australia's priorities seemed to swing back clearly in the direction of America and the West, and away from the enthusiastically pro-Asian sentiments of his predecessor, Paul Keating. On the very day on which the new government was sworn in, America dispatched two aircraft-carrier battle groups to the Taiwan strait after China started lobbing missiles towards the island. Mr Howard endorsed the deployment, to Chinese fury.

The Asian financial crisis of 1997-98 caused a certain amount of *Schadenfreude* among Australians, who still remembered the warning issued in the 1980s by Singapore's prime minister, Lee Kuan Yew, that they risked becoming the “white trash of Asia”. It also led directly to the collapse of General Suharto's regime in Indonesia, which in turn led to the event that most alienated Australia from its Asian neighbours: its intervention in East Timor, after that wretched Indonesian province voted for independence and then descended into mayhem. In 1999, Australia organised and headed a multinational peacekeeping force to which it contributed 5,700 of its own troops, half the total. Though this was done with the acquiescence of the Indonesian government, it was hugely resented, especially by the powerful Indonesian army. Throughout the presidencies of B.J. Habibie and Abdurrahman Wahid, and well into that of Megawati Sukarnoputri, relations between Australia and the largest and most powerful member of the Association of South-East Asian Nations (ASEAN) remained glacial.

At the same time, ties with America improved, especially following the election of George Bush, whom Mr Howard found much more congenial, personally and politically, than Bill Clinton. But the biggest change came on September 11th 2001. Mr Howard felt the terrorist outrage deeply, all the more so because he was in Washington, DC, on that fateful morning. Australia invoked the right of collective self-defence under the ANZUS security pact to pledge its support for America. Along with Tony Blair, Mr Howard has proved one of America's most steadfast allies in the war on terror, volunteering to send Australian troops for the invasion of Iraq even though the war was deeply unpopular in his country. Although several Asian countries, including Japan, South Korea, Thailand and the Philippines, later sent troops too, Australia's two Muslim neighbours, Indonesia and Malaysia, were strongly opposed. Mr Howard did not help matters by agreeing with an interviewer that he was America's “deputy sheriff” in the region.

Good out of evil

Two tragedies have helped to reshape Australia's relations with South-East Asia. The first was the Bali bomb of October 2002, which counted 88 Australians among its 202 victims. In its wake, the police forces of Indonesia and Australia embarked on a programme of close co-operation that worked, and has gone on working, surprisingly well. Some 30 people suspected of involvement in the attack have been rounded up. Jemaah Islamiah, the al-Qaeda offshoot held responsible, may not have been eliminated, but it has been badly weakened. The Australian intelligence services now work very effectively with their counterparts in Indonesia, Malaysia and Singapore, and this practical co-operation has given a boost to the relationship at higher levels. For example, Mr Howard last year attended the swearing-in ceremony for Indonesia's president, Susilo Bambang Yudhoyono, a courtesy he had not extended to previous presidents.

A further sign of Australia's rehabilitation in the eyes of ASEAN came last November, when Australia (along with New Zealand) was invited to attend ASEAN's summit meeting in Laos. Shortly after that came the second tragedy that profoundly changed Australians' and South-East Asians' views of each other: the tsunami of December 26th. The response by ordinary Australians was magnificent. They donated about A$300m ($235m), to which the government added A$1 billion. But even in such adversity old habits die hard: the troops Australia sent to the devastated province of Aceh were viewed with suspicion by the Indonesian armed forces, which are suppressing a secessionist uprising there.

Plainly, there are still tensions: Mr Howard caused offence by refusing to sign up to ASEAN's “treaty of amity and co-operation” which he instinctively feels is anti-western. In general, he has preferred bilateral arrangements to multilateral ones. This has its drawbacks: driven mainly by concern about China, Asia is moving fast towards some form of regional institution-building, with a planned “East Asian Community”, consisting of the ten ASEAN nations plus China, Japan and South Korea, being its most promising form. Mr Howard must do much more to ensure that Australia is moving in the same direction. In the end, he will probably have to back down and sign the treaty.

The use of bilateralism as a political and economic tool is also much in evidence. Last year, Australia completed negotiations on a free-trade agreement (FTA) with America, which took effect on January 1st. It has also signed FTAs with Thailand and Singapore, and is studying one with Malaysia. The real prize, though, will be the proposed FTA with China, potentially the first that China will sign with a developed country.

If ever there were two countries that were made for each other, at least economically, it must be Australia and China. Australia has the raw materials—coal, iron ore, gas and even oil—that China needs; China makes all the manufactured goods that Australia needs to import.

A graph of a country's demand for raw materials, as it happens, looks a bit like a boomerang (see chart 5). At a certain stage of development, as with, say, Japan in the 1950s and 1960s, demand for metal and coal becomes intense as rail networks are built and demand for cars, fridges and other materials-heavy goods soars. Later on, as the country gets richer still, demand switches to less weighty goods: financial services, music, movies and holidays. Australia's good fortune is that, not long after Japan began its backswing, China started booming. And it could be a long time before China's demand for raw materials starts to ebb. Once the rift caused by the Taiwan crisis in 1996 had healed, Mr Howard started courting the Chinese and never stopped. This year's statistics are likely to show that China has become Australia's second-biggest trading partner, taking over from America (see chart 6).

If it could, Australia would go on happily being friends with both China and America. But there is one obvious problem, notes Hugh White, head of the Strategic and Defence Studies Centre at the Australian National University. In the past, Australia's biggest trading partner, Japan, was a close ally of its closest ally, America. The America-China-Australia triangle is a different construct altogether.

Before September 11th 2001, China was regarded as a "strategic competitor" in Washington—and as the engagement in Iraq winds down, it is sure to become so again. Already, tension between America and China over Taiwan has been ratcheted up a few notches. And Australia has already been drawn into Sino-American rivalries by an American demand that it help lobby European countries not to lift their arms embargo against China.

This unwanted loyalty test will seem as nothing compared with what will happen if America has to assert itself again in the Taiwan strait, and asks—as it surely will—for Australian support, citing the ANZUS pact. The difficulty of being all things to all men would rapidly become apparent.

The near abroad

These storm-clouds aside, one unsung success of the Howard years has been its willingness to take up the burden of the South Pacific, a collection of dysfunctional island nations that no one else wants to grapple with. The first instance was the Australian-led intervention in East Timor, in 1999: but that involved two dozen countries and was blessed with a full-scale UN Security Council resolution. More recently, Australia has found itself drawn into much smaller-scale operations with a big civilian component in the Solomon Islands, in Papua New Guinea and even in Nauru: all countries that became independent only in the late 1960s or 1970s, and have signally failed to prosper. Elsina Wainwright, an analyst at the Australian Strategic Policy Institute who has written on Australia's "near abroad", sees September 11th as instrumental: it helped to focus minds on the dangers of failing states.

The Solomons, a collection of 1,000 islands wracked by civil war and political and economic breakdown, marked a key departure for Australia. Little more than two years ago, the Australian government was still insisting that it could not "presume to fix the problems of the South Pacific countries". But as the situation in the islands, a three-hour flight from Brisbane, continued to deteriorate, the government performed a complete U-turn. In July 2003, it established and led a multilateral, but overwhelmingly Australian, regional-assistance mission. The Australians are now training the Solomons' own police, and have brought in a team of civil servants to help rebuild the country's economy so that it will eventually be able to function on its own.

But what really spooks Australian planners is Papua New Guinea. It is far bigger than the Solomons (5.8m people rather than 500,000), very much closer, and was an Australian colony until 1975. It has an appalling AIDS problem, a history of attempted secession and abortive coups, and an economy that has stagnated since independence. In the hope of forestalling its collapse, Australia has long thrown money at it: now it is throwing people.

In an exercise modelled on the Solomons intervention, but without the military component, Australia in December 2003 launched its “enhanced co-operation programme” for Papua New Guinea, sending Australian police officers and civil servants to work there. Something similar, but on a much smaller scale, is happening in Nauru. The jury is still out on the new doctrine of “co-operative intervention”, but at least the Australians are trying.

If only they could show the same imagination in their relations with East Timor, which they bravely helped create in 1999. Australia and the world's newest country are still locked in a nasty argument over the share-out of revenues from oil deposits in the Timor strait.

The original deal, based on a carve-up going back to the time of Suharto, when Australia was one of the few countries in the world to recognise the occupation of East Timor, was extremely favourable to the Australians. It should now be renegotiated, because on any reasonable reckoning most of the oil lies in Timorese waters. Australia has offered big concessions, but not yet big enough. Its continued meanness to East Timor is a blot on its otherwise shining foreign-policy record.

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God under Howard

May 5th 2005
From The Economist print edition

The prime minister keeps on winning elections because he understands how Australia has changed

Newspix

God loves us

TEN minutes into the service, and several young women are openly weeping. Others are collapsing into their seats, apparently in religious ecstasy. Almost everyone is reaching out with their arms, palm forward, hoping perhaps to touch the face of God, but lending the proceedings an oddly sinister air. Welcome to Hillsong, said to be Australia's fastest-growing church, having risen from a congregation of 45 when it first started in 1983 to more than 15,000 now. Well over 2,000 people pack into its hangar-like hall in an inner suburb of Sydney for just one of five Sunday services, each 90 minutes long. Afterwards they queue to buy recordings of the sermon they have heard in the flesh only minutes earlier. Not one but two collections have been taken.

Hillsong tells people what they want to hear: that God loves them, that they are special, that if they believe they will prosper. Not much is said about loving your neighbour as yourself—or indeed about an austere and unworldly man named Jesus. Pastor Brian Houston, who founded Hillsong, once wrote a book called “You Need More Money”. This is not so much religion but self-help for the would-be affluent. But with its heavy-rock hymns of praise to the bountiful Father, its massed choirs, its dancers and its howling preachers, there is no denying that, on a certain level, it works.

It may be tempting to dismiss Hillsong as an extreme example of “prosperity Christianity” and ignore it, but John Howard and his Liberals certainly haven't. In 2002, when Hillsong opened a new, bigger complex in north-western Sydney, Mr Howard came along to open it. Peter Costello, the treasurer, has spoken at Hillsong's annual conference. In fact, many members of the Howard cabinet are devout Christians (although Mr Howard himself is somewhat ambivalent). In Canberra these days, political prayer breakfasts have become unmissable.

Yet the place hardly seems to be in the grip of the religious right. A couple of miles from the Hillsong church is Oxford Street, with a high concentration of gay bars and clubs: Sydney and San Francisco still vie with each other for the title of the world's gay capital. Those otherwise inclined would not have to walk far to find a number of entirely legal brothels. Australia's evangelical churches may be booming, but the country still embraces staunchly liberal values. Yes, Tony Abbott, the health minister (and a former monk), has been allowed, from time to time, to raise the subject of abortion. But no one seriously believes that the Howard government is going to open that Pandora's box. Yes, Family First, a new party

of the right, picked up a Senate seat in last year's election. But the Senate's election rules are so strange that such quirks can happen—and then fizzle out again.

The attention paid to Hillsong is a symptom of something much broader: Mr Howard and his party have understood, and profited from, a big shift in Australian attitudes. When he first came to power, he said he wanted to preside over an Australia that was “relaxed and comfortable”, a remark that was much derided at the time, but has come in a way to define his leadership. After the economic upheavals of the 1980s and early 1990s, Australians now want to turn inwards a little and concentrate on their own families and homes, says Hugh Mackay, a social researcher and journalist. Not for nothing has “Backyard Blitz” been one of the most popular television programmes of recent years, at a time when six of Australia's top ten charities have seen their takings fall.

By 1996, Labor had alienated too many Australian battlers with its obsessions with ending the monarchy, declaring Australia part of Asia and apologising to its Aborigines—none of which are “barbecue stoppers”, as Mr Howard would say. The secret of his success, he insists, is that he listens to people, not least by frequently going on “talk-back” (phone-in) radio. “We've ended the perpetual seminar on our identity,” he claims.

From the suburbs

With four general-election victories under his belt, Mr Howard is probably the most successful serving democratic leader in the world—and most observers reckon he intends to run for a fifth term in 2007. The secret of his success is to be found in the suburbs, the vast sprawling expanses of Australia's five big cities, and most of all in Sydney. It is pre-eminently here, in the Sydney suburbs, that Australian elections are won and lost. And it is here that the Liberals have made deep inroads into what was once solid Labor territory.

Liberal politics, reckons one pundit, is about ignoring the people who are never going to vote for you, ignoring the people who are always going to vote for you and concentrating on those in the middle. In the run-up to last October's election, the government targeted the kind of lower-middle-class young families who live in the Sydney suburbs. It announced huge give-aways for families and tax breaks for middle-income earners. In all, it promised an extra A$66 billion ($51 billion) over four years. It seemed to work.

Increasingly, the suburbs are places not of deprivation, but of aspiration. Take Campbelltown, a district in south-west Sydney that falls partly within the national constituency of Werriwa, the seat once held by Gough Whitlam, Labor's 1970s prime minister, and more recently by Mark Latham, who led Labor to catastrophic defeat in last October's general election. The Liberal Party hardly bothers to campaign here: at the Werriwa by-election in March, held to replace Mr Latham, who quit Parliament, it did not even field a candidate.

Even so, on the Campbelltown council Labor cannot muster a majority. Campbelltown's Labor mayor, Brenton Banfield, is honest enough to acknowledge that Mr Howard makes a good job of coming across as “an average bloke”, the sort that understands the suburbs. He is right, because that is where the prime minister comes from. He is the son of a garage owner from the Sydney suburbs, whereas his opponent, Kim Beazley, is the son of a Perth MP and minister.

And although Campbelltown has its pockets of high unemployment—you even see the odd graffito in Glenquarry Estate—most of it looks prosperous, and is becoming more so. Its green hills are alive with the sound of building, and its ritzier areas, such as Denham Court, are the site of amazing mansions built by local people who have made good. Will such people go on voting Labor? Perhaps not.

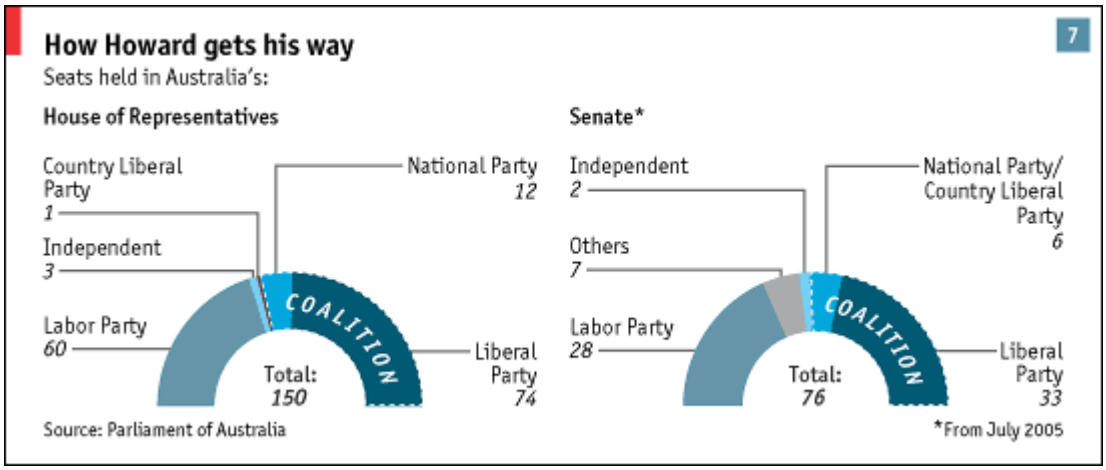
It is often said that Mr Howard keeps on winning elections because of the economy, stupid. But it isn't quite that simple. Of course a 14-year boom helps, but voters seem to realise full well that the groundwork was laid by Labor's reforms. Labor now has to do more than just convince voters that it can handle the economy as well as the Liberals; it needs to convince ordinary middle-class people that it understands their concerns. The trouble is that too many of Labor's leaders are creatures of the trade unions: at worst, apparatchiks such as Simon Crean, a former leader of both the trade-union movement and of the Labor party and now shadow trade minister; at best dependent on union money and votes. Yet only 23% of the workforce are unionised.

The enduring power of the unions was neatly demonstrated in January, when Labor had to choose a new

leader following the resignation of Mark Latham, who had led them to defeat in last October's election. The man they should have chosen was Kevin Rudd, by far the brightest talent on the Labor front bench. But Mr Rudd is a former diplomat, not a union man. Insiders say that he was in with a chance until the Queensland unions more or less ordered their MPs not to support him, handing victory to Kim Beazley, the veteran former leader whom Mr Howard has defeated twice before.

That said, the present opposition front bench looks a good deal less union-dominated than in the past, and now boasts some impressive talent, including Mr Rudd, Wayne Swan, the shadow treasurer, and Stephen Smith, the shadow minister for industry.

Another factor against Labor is Australia's federal system. The state governments spend the money that touches people's everyday lives: on local roads, on schools, on doctors' surgeries (though not on universities). Federal government spending goes on things that seem more remote, such as defence and foreign policy, as well as macro-economic management.



Bill Bowtell, a political consultant, borrows a line from an American columnist, Maureen Dowd, to describe state governments as the natural province of “Mummy” parties—sympathetic and happiest when doling out wads of cash—whereas the federal government is best suited to “Daddy” parties: stern, moralistic, taking tough and unpopular decisions. That is why, he reckons, the Liberal-led coalition has been in power in Canberra for 34 of the past 50 years, against Labor's 16, and why Labor controls every one of Australia's state governments.

There is, though, a little hope for the opposition. Labor has at least started to understand that it cannot afford to cede the economy entirely to the Liberals. Mr Swan, the new shadow treasurer, has been banging away at the government for not investing enough, to some effect.

Mr Beazley has a fine line in indignation when he savages the government for squandering Labor's legacy by failing to invest and using its surpluses for questionable projects in marginal constituencies. But too often, Labor still talks in terms of insiders and outsiders. The problem is that most Australians now consider themselves neither; they simply feel classless and successful. Perhaps Australia has just become more selfish. If so, that is both parties' doing; but Mr Howard's has been much better at exploiting it.

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Australians old and new

May 5th 2005
From The Economist print edition

The country seems to be at ease with its newest arrivals, but not yet with its first inhabitants

Alamy

Not yet reconciled

IT SEEMS hard to believe that only a few years ago Australians were fretting, and the rest of the world gaping, at the meteoric rise of a chip-shop owner from Queensland. In 1996 the unknown Pauline Hanson stunned everyone by winning a seat in the federal Parliament. She then founded a party, One Nation, which won 23% of the vote and 11 of the 89 seats in a Queensland state election in 1998. In the general election in the same year, it bagged 9% of the national vote, though only one Senate seat.

Mrs Hanson's message amounted to a mixture of complaints about unemployment, taxation and globalisation—the small-town, small-business gripes that have fuelled populist movements down the decades. But two of her claims were seen as especially alarming: that the government was favouring Aborigines over white people, and that immigration was hurting the average Australian. “We are in danger of being swamped by Asians,” she said in her maiden speech in Canberra.

Mrs Hanson and her party have already become merely a footnote of history. The lady herself was convicted of padding out her party membership list to qualify for election expenses, though the conviction was overturned. She fell out with her party and ran as an independent in last October's general election, losing heavily. Remarkably, her crusade seems to have had little long-term effect: anti-immigrant feeling in most other rich countries runs much hotter, and a party like One Nation would not have faded so fast. Australia, despite Mrs Hanson's claims, is probably more receptive to immigration than any other country.

It has not always seemed that way. In August 2001, the Howard government, then facing a difficult election, scored a noticeable bounce in the opinion polls after the *Tampa* affair. The *Tampa* was a Norwegian ship that the Australian government ordered out of its waters after it had picked up 433 refugees, most of them Afghans, from their own leaky boat. The government argued that allowing boat-people to land merely encouraged a dangerous traffic and gave them unfair precedence over others patiently waiting in third-country holding centres for their chance of a new life in Australia. But the way that the policy was used for political advantage, with some success, has done lasting damage to Mr Howard's reputation. Still, it is worth recalling that the Labor Party supported the decision to push the *Tampa* back.

The *Tampa* affair made the Howard government look racist, but the figures tell a different story. In the year to June 2005, Australia will have admitted around 120,000 immigrants, as well as almost 14,000 refugees. As a share of Australia's population of just over 20m, that is well above the number for America, which takes in around a million a year but has a population 15 times greater. Moreover, the

Australian intake has been slowly creeping up during the Howard years. As with many things, it is better to look at what the government does than what it says.

In 2005-06 the total is set to rise by 20,000 because of Australia's labour shortage. “We can take so many precisely because we control the borders,” says Amanda Vanstone, Australia's immigration minister. “And for our refugees, we aim to give priority to those most in need, not those who can pay for passage.”

There have been changes in the mix of immigrants too. The “White Australia” era is long gone: these days, more than a third of each year's intake comes from Asian countries, and the proportion goes on rising. Around two-thirds of immigrants are now admitted on the basis of their skills, using a points system to pick the most useful people; the other third comes from reuniting families. The points allocations can change from year to year as the needs of the economy alter. Critics call this cherry-picking from poor countries that desperately need the services of the trained people they have invested in. But nobody disputes that the system benefits Australia. With unemployment so low, the country could easily take in a lot more immigrants—as many as 250,000 a year by 2025, reckons Phillip Ruthven of IBIS.

To the visitor, Australia seems like a model of harmonious race relations. No matter where you come from, people assume you are a native because in this melting-pot of a place you might very well be. Ahmed, a Kurd who escaped from Saddam's Iraq in the 1980s and now drives a Sydney taxi, says he has never encountered any real racism. “This is a great country. If you want to work and stick to the law, people are going to welcome you here, and you can do well,” he says.

Some have done very well indeed. John So arrived in Australia as a poor immigrant from Hong Kong 30 years ago. Today, he is Lord Mayor of Melbourne, Australia's second-biggest city, having twice been directly elected to the job. “Melbourne is a showcase for Australia's multiculturalism,” he says. Its Lunar New Year celebrations attracted 200,000 people, and Diwali and the Thai water festival also bring in the crowds. Australia has always been a land that welcomed people, a land of immigration, says Mr So: it is just the origins of the people that keep on changing. In other countries, he thinks, such high levels of immigration might not work. But what, after all, is Australian culture? It is always shifting. “That's how a Chinese immigrant can become Lord Mayor,” he explains with a smile.

A quarter of Australia's population was born abroad, and another quarter is made up of first-generation natives. At a time of globalisation, this is a tremendous strength, and with unemployment at its lowest level for almost 30 years further immigration is unlikely to provoke much discontent. Parts of Sydney are already starting to feel noticeably Asian. The suburb of Cabramatta, in the south-west, has a large Vietnamese population: walk around its main market area, and you will hardly see an English sign. But it is not a ghetto: most people who live there work elsewhere, and as people get richer, they swiftly move to more affluent areas.

The first shall be last

If Australia has embraced its immigrants, it has been much less successful in coming to terms with its terrible past. When Captain Arthur Philip landed with the First Fleet at Sydney Cove in 1788, the original Australians had already been there for 50,000 years. There were, perhaps, a million of them, members of some 300 distinct “nations”. The settlers seized their land, driving them off it and shooting them if they resisted. Because the Aborigines did not practice settled agriculture, they were deemed to have no claim to the continent they inhabited. Today, there are just 400,000 Aborigines and Torres Strait Islanders (natives of the far north).

In every sense, the Aborigines are at the bottom of the heap in Australia. They did not get the vote until 1962. Their life expectancy is 21 years less than the Australian average, with double the rate of infant mortality. Aborigines are three times as likely to be unemployed as the average Australian, and 16 times as likely to be in prison. Even where they remained on their ancestral land and found employment under white farm-owners, new equal-pay rules in the 1960s worked to their disadvantage: compelled to pay Aborigines the same as other workers, the farmers preferred to fire them.

In a remote town such as Katherine, in the Northern Territory, it is easy to see the scale of the problem. Wherever there is a patch of grass, it is likely to be occupied by a group of Aborigines who have trekked in from outlying communities, where there are no jobs and nothing to do, and are simply camping out. Often, they turn to drink.

On the other side of the continent, in Dareton, a small township just north of Mildura in New South Wales, a group of Barkindji elders paint a picture of a dismal life. There is work for no more than four or five weeks a year, they say, picking fruit. There are development projects, but most of the money gets creamed off by “whitefellas”. The Aborigines are charged more in shops than the whitefellas, and they live in the most basic public housing. These are, perhaps, the most unfortunate of all the Aborigines: neither making their way in the cities, where some, especially those of mixed race, have done well, nor living the traditional life that still continues in the remoter north, but existing on the margins of the farmland that once belonged to them.

There are a few signs of hope, but not many. One is that Aborigines are at last starting to take part in mainstream political institutions. John Ah Kit is a minister in the Northern Territory's government, one of only two Aborigines to hold such high office. Four of the 13 Labor members of the 25-strong state Parliament are Aborigines. “Our people used to feel excluded from government, but we're trying to change that,” says Mr Ah Kit. In New South Wales (where there are larger numbers of Aborigines, but they make up a much smaller percentage of the total), Linda Burney, a state MP, is an eloquent and visible fighter for her people's cause.

Another undoubted bright spot is painting: aboriginal art, a haunting swirl of colours and shapes, has taken off in a big way in Australia and in the wider world. A third reason for optimism is minerals: many firms now accept that they should pay at least some royalties to the land's traditional owners, even though there is no legal obligation.

Australia has at last accepted the obvious, that a terrible injustice was done, and that restitution ought to be made. But how? The drive for reconciliation has taken two main routes. One is legal: in a ground-breaking decision in 1992, the Australian High Court accepted for the first time that there was such a thing as “native title”—a concept that struck down the doctrine applied by the British settlers that the land they had found was *terra nullius*, belonging to no one.

Native title, however, as was clarified by further legislation and case law, is not usually the same as ownership. It involves a package of rights, such as the right to graze and to hunt, the right of access to sacred sites, and the right of transit. It does not, in general, confer a right to royalties from any minerals that might be found under the ground, and it can co-exist with other rights, such as pastoral leases. But formal leases take precedence, and can often extinguish native title altogether.

Ours, but not ours alone

Native title generally accrues to communities rather than individuals, and therefore cannot be traded. It is not, in short, all that valuable; and it is extremely difficult to establish in the first place. To assert it, a group must demonstrate a continuous connection with the land in question. As Rick Farley, a dogged campaigner on aboriginal and agricultural issues, puts it: “That's a bit hard if you can't get to your ceremony grounds because you've been out on a mission or reserve, or because the pastoralist wouldn't let you on to his lease, or because there is no record of your grandfather on his traditional country.” Native-title cases are also expensive to bring. The main beneficiaries seem to have been the lawyers.

Also promising at first, but in the end even more disappointing, has been a policy of returning land to the Aborigines. From the early 1970s onwards, a number of government-funded Land Councils have been charged with acquiring land for Aborigines. Again, the land in question does not go to individuals but is held collectively. The biggest of these schemes was set up in the Northern Territory, where Aboriginals and Torres Strait Islanders make up a quarter of the population. Four councils there own about 44% of the Territory, having bought it from existing owners or, more usually, having had Crown land transferred to them. Similar but smaller schemes operate in the other states. In all, around 16% of Australia is owned in this way. But there are no prizes for guessing that most of it is remote and unfarmable.

Noel Pearson, a prominent Aboriginal leader, has long argued that encouraging people to remain on such land, where they are almost totally dependent on the “poison” of welfare, is a disastrous policy. Some draw a comparison with the reservations on which American-Indians have become progressively more alienated from the rest of America.

Sadly, the Howard government has come up with very little in the way of fresh or interesting alternative policies. Many Aborigines now seem to have nothing more to hope for than an apology for such terrible abuses as the “stolen generation”: Aboriginal children taken from their mothers to be brought up by whites, an evil that went on until the 1970s. And it is sadder still that Mr Howard stubbornly refuses to

offer that apology.

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Drizabone

May 5th 2005
From The Economist print edition

But water shortages can be overcome

Alamy

Battle on

THE Great Anabranch of the Darling river on the edge of the outback in remotest New South Wales looks far from great these days. A looping 290-mile (460km) subsidiary course of the Darling, its lower reaches ran dry two years ago after ten years of drought. Now its bed is dry red dust. Spear grass and salt bush have sprouted along its length. Not even insects stir in the heat of the austral summer. It seems impossible that life could go on in such a waterless place but, however tenuously, it does.

The Anabranch used to water a string of 40 big farms along its length, including Bulpunga, home of Keith Forster and his wife, Pauline. Mr Forster's farm, at 10,000 acres (4,100 hectares), is one of the smaller stations: the average is four times that, and the largest over 100,000. But without water, they all face ruin. Mr Forster has stoically sold off most of his sheep. The land used to support around 3,000 of them; now he has only 100, and those only thanks to a well, unused since his grandfather's time, that he rediscovered. Even in normal times, each sheep needs three or four acres, rather than a single acre being able to sustain five or six sheep, as in rainy England. Mrs Forster has let her garden go, except for some plants in a few sad pots.

This is the Australia that Jared Diamond has written about in his latest book, “Collapse”. This American anthropologist shows how over-farming has exhausted Australia's soil, and how too much clearing by man and trampling by sharp-hooved sheep has harmed its ability to retain water, exacerbating the effects of drought and increasing its salinity. What little water there is has often been wasted on growing inappropriate crops. He concludes that there are too many people. The best estimate of a sustainable population is 8m, he says, well under half the present figure of 20m.

Mr Diamond's analysis is right, but his conclusion looks wrong. It underestimates the resourcefulness of men like Mr Forster, and the impressive efforts that Australia's government is now making to deal with its water problems. As a continent in its own right, Australia is able to take full control of them, unlike countries such as Pakistan or Israel that depend on rivers arising beyond their boundaries.

Along the Anabranch, Mr Forster is managing a project to replace the natural flow with a network of pipelines, drawing water from the Murray river to the south as well as the main stream of the Darling. The 190 miles of plastic pipe and the required pumping stations will cost A$54m ($42m), but will safeguard 2m acres of farmland. The scheme will also save water, avoiding losses from evaporation and seepage, and should be ready in a year.

Mr Forster's scheme for husbanding this precious resource is only one of scores. And in urban areas, Australia's state governments are playing their part by promoting water efficiency with hard cash. Most important of all, much of Australia has developed what is probably the world's most advanced water-pricing and trading system. Farmers have to pay for their water; a basic allocation to cover human and animal needs comes with their land, but anything beyond that, say for crops, costs money. The more you pay, the more priority you get if supplies run short. Farmers who do not use their full allocation can sell the remainder; indeed, anyone can take part in the water market, and water rights are now increasingly being separated from the land they came with.

There is, however, a catch. Water markets are well developed in New South Wales and Victoria, the dry southern states that depend on the Murray and the Darling. But in Queensland, where the Darling rises, they are lagging behind. Because Queenslanders get plenty of rain (the tropical north of Australia has no water shortages), they are profligate with the precious resource, starving the downstream Murray-Darling system, Australia's principal river network. Irrigation in Queensland is often done by means of open channels, not pipes, so much of the water is lost. Crops grown include water-hungry cotton and rice, which Australia should probably leave to wetter countries.

Ideally, the market would sort this problem out: if water in Queensland were priced according to national rather than local needs, Queenslanders would use it more carefully. But Australia's federal system gets in the way. Water is traded effectively within states, but not across state borders. Eventually, though, the federal government in Canberra will surely take control and establish a single national water market. Work on this is under way.

Mr Diamond is being too pessimistic, for several reasons. One is Australians' willingness to embrace radical change when they have to. Another is the power of technology. Perth and Adelaide, the two big Australian cities with the worst water-supply problems, are both starting to experiment with desalination, which science is making more efficient and affordable. Australia has a predominantly coastal population with a plentiful supply of sea water and abundant access to energy, in the form of coal, uranium (though it would have to overcome its aversion to nuclear reactors first) and solar power, for which the country's vast, empty, sun-baked interior presents ideal conditions. Besides, there is plenty of water in tropical northern Australia. Great pipelines might carry it south. Or perhaps Australians, who have tended to settle in the temperate south, may start to migrate north.

Room for many more

No one knows how many inhabitants Australia might, in time, come to support. A century ago, people talked of an eventual population of 100m. These days, expectations are more modest, but 50m by mid-century seems entirely possible. Living on the driest inhabited continent is a challenge, but Australia's battlers have shown they can overcome it. They have turned around a failing economy and made it one of the world's most dynamic and resilient. They are coping with radical demographic and ethnic changes. They belong both to the West and to Asia. They have created a tolerant yet orderly society, and have married mateship with rugged individualism. They have got the ticker.

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Packaged food

Making a meal of it

May 5th 2005
From The Economist print edition

FMI

A crisis of creativity is causing rumblings in the food industry

JUDGING by the thousands of new products at the Food Marketing Institute's show in Chicago this week, the makers of packaged food are an inventive lot. Hundreds of firms, ranging from family-run outfits to giant multinationals, laid out their wares at one of the world's biggest supermarket-trade events, hoping to attract the attention of retail executives seeking hot new products and emerging trends.

Yet despite all the buzz, the food industry is falling behind in its ability to innovate. This will cost companies heavily as supermarkets' own-label goods grab an increasing share of the market, especially for products aimed at the growing number of health-conscious consumers.

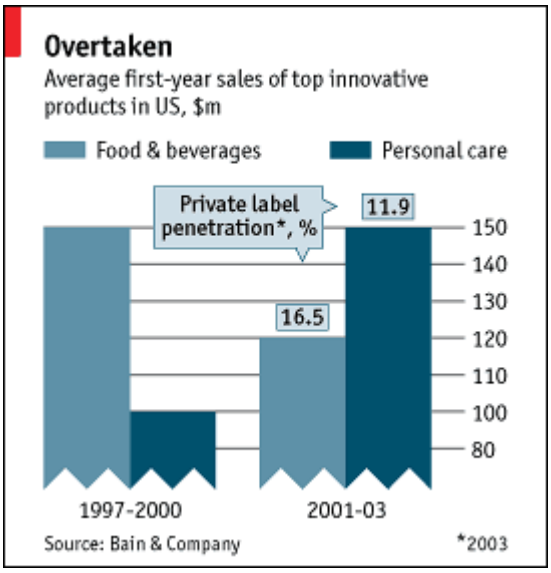
The worldwide packaged-food business was worth about $1.4 trillion last year, according to Euromonitor, a market-research firm. The so-called “health and wellness” segment is the fastest-growing bit. This consists of organic products; fortified or “functional” foods (usually with added ingredients, such as vitamins); and “better-for-you” ranges (with things like sugar, salt or carbohydrates taken out).

In 1997-2000, innovations in food and beverages outpaced those in another crucial consumer-goods market, personal-care products (everything from razors to toothpaste), according to a new study by Bain, a consultancy. That has since been reversed. The most innovative food products once could expect average sales of $150m in their first year, compared with $100m for the most innovative personal-care products. But since 2001 first-year sales of top new food products have fallen to $120m, while sales of such personal-care products have risen to $150m (see chart).

Eating their lunch

Innovation is crucial in driving sales of consumer goods, especially when competing against a retailer's own-label products, says John Blasberg, the head of Bain's North American consumer-products practice. With big supermarket chains such as Wal-Mart, France's Carrefour and Britain's Tesco taking a bigger proportion of consumer spending, this battle is intensifying. By 2003, private labels accounted for 16.5% of sales in America, compared with 11.9% in personal care, says Bain. In Europe, private-label

penetration in packaged foods, particularly in “ready meals”, is above 20%.



Most new food products now tend to be extensions of an existing line, for example, a vanilla-flavoured cola, rather than a new category, such as Crest's Whitestrips for whitening teeth. Food firms need to invest more in research and development, says Bain. It calculates that personal-care companies spend an average of 2.6% of sales on R&D compared with 1.6% by food and beverage companies. Food firms must also become faster at launching new products and quicker to exit when demand wanes, adds Mr Blasberg.

The packaged-food industry's reaction to low-carbohydrate diets typifies the problems. Many leading brands have been launching new low-carb products recently, just as the market has peaked. Two years ago, the soaring popularity of the celebrity-endorsed low-carb diet promoted by the late Robert Atkins saw sales of eggs and steak soar as those of carbohydrate-rich products, such as bread and pasta, slowed. A fad or a long-term trend?

Either way it presented food firms with a big opportunity—if they could move fast. Some did. In 2004, the number of new low-carb products jumped from around 500 to some 5,000. Sales exceeded $2 billion in America last year. But by autumn the market was turning down. Now the talk in the industry is of products being axed and of truckloads of unsold low-carb snacks and meals being donated to charities for the homeless. In March, AtkinsNutritionals, the commercial arm of Dr Atkins's legacy, sought bankruptcy protection for its British operation.

Even so, new low-carb products are still coming to the market, including a low-carb potato developed in Florida. In Chicago this week, Kraft, one of the world's biggest food firms, unveiled its new line of “South Beach Diet” products, produced in association with an Atkins rival.

Many food firms believed that low-carb foods might prove only a short-term opportunity—but not that short, says Christiana Benkouider, research manager for health and well-being products at Euromonitor. In the rush to get new products to market “taste probably suffered as a result,” she says. It was the “avalanche” of new products that helped cause the spike in the market, says Matt Wiant, chief marketing officer for Atkins Nutritionals. He blames the firm's British woes on operational problems but believes that in various ways low-carb foods will remain an important part of the health market.

Whether or not he is right, future innovation is likely to come increasingly from small firms. They have led the development of organic products, points out Bain. Over the longer term, organics has been the fastest-growing packaged-food sector.

Large firms will often look to smaller ones to provide the innovation they lack—and then buy up the successful ones, says Roy Bingham of Health Business Partners, an investment banking firm specialising in nutrition and consumer health-care. As he points out, one of the chief problems faced by big companies is that, by definition, new products that claim to be healthier signal to consumers that existing ones may not be. So to avoid cannibalising sales, big firms must know the difference between a fad and a trend. With even fast-food chains such as McDonald's and Burger King adding healthy options to their menus, and governments becoming increasingly concerned about obesity, healthier food definitely looks

like a trend.

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German food

Asparagus angst

May 5th 2005 | FRANKFURT
From The Economist print edition

Stemming the flood of Polish workers

EPA

Not a job for Germans

THE annual asparagus frenzy is under way in Germany. Wooden huts at thousands of road junctions, selling only asparagus, have opened their shutters to offer foodies the delicate white stems. Asparagus lovers should enjoy it while they can. The price, which has already hit new highs of €7-8 ($9-10) a kilo, may soar in future—largely as a consequence of Poland joining the European Union last May.

Membership of the EU brought with it an obligation for around 280,000 Polish seasonal workers, the mainstay of the German asparagus harvest, to make social-security payments at home—one-quarter of their pay packet—during what has traditionally been regarded as paid “holiday” in Germany. Moreover, German farmers are (in theory) supposed to make payments towards Polish social benefits, of one-fifth of the gross wage.

Until last month, German farmers and their Polish employees ignored such requirements. Nor was the Polish government much bothered. But an insurance claim by a Pole injured in Germany raised some awkward questions. Two weeks ago, at the behest of German farmers, Heinrich Thiemann, an official in Germany's Ministry of Health and Social Security, flew to Warsaw. He persuaded Poland to ignore the liabilities for 2004 and the first half of this year—ie, this asparagus season.

But this concession by the Poles has caused a ruckus in Berlin. The economics ministry fears that it is an infringement of European law. Trade union leaders, who are much exercised by the influx of workers from Poland and other new members of the EU, complain that it is an example of government-sanctioned wage dumping that is depriving Germans of jobs.

After all, surely the Poles could be replaced by some of Germany's 5m jobless? Most farmers are horrified at such suggestions. Cutting asparagus stems is backbreaking work—most of the long-term German unemployed are over 40 years old. The Poles come for three months and live on the farms, where they are welcomed as an eager, friendly workforce. The German jobless would face big transport costs; and most of them, even under labour reforms that took effect this year and penalise “unwillingness” to work, would turn up their noses at the typical €5 per hour pay rate. Even so, a few farmers have tried using German workers, only to find them “unreliable”, except at producing eloquent excuses for not showing up. Asparagus is prized not least for its freshness and symmetry, and needs workers to be there to harvest it at exactly the right time.

Why not recruit from countries still outside the EU, such as Romania or Ukraine, then? Alas, the workers may be cheap, and not require benefit payments, but they do not have the know-how of the Poles, most of whom have done the job for years.

One consolation for the farmers: the feeding frenzy is usually so great that prices could probably hit €10 a kilo before turning off many German consumers. But the same may not be true of more humdrum crops, such as cucumbers, strawberries and other fruit, which Polish workers tend to harvest later in the year.

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Retailing

Shopping spree

May 5th 2005 | NEW YORK
From The Economist print edition

A $5 billion luxury purchase

WHERE else can one buy a zeppelin for $10m? Few other places sell jewelled Mr and Mrs Potato Heads for a mere $8,000 each. Other than Paris Hilton's pad or the queen's Balmoral Castle, where can you be waited on hand-and-foot in marble-floored rooms adorned with Picassos? Neiman Marcus is in every sense exceptional. This week, the super-high-end department-store chain sold its most expensive product—itself—for just over $5 billion. The buyers were two private-equity firms, Texas Pacific (which has also invested in retailers such as Debenhams in Britain and J-Crew in America) and Warburg Pincus.

Neiman Marcus is the latest big-name retailer to be acquired. In the past three months, Kmart has bought Sears Roebuck; Federated Department Stores, owner of Macy's and Bloomingdale's, has bought May Department Stores, owner of Lord & Taylor and Filene's; and Goldner Hawn Johnson & Morrison, another private-equity firm, paid $1.1 billion for the ShopKo chain. On April 29th Saks sold its regional stores, and will focus on its high-end Saks Fifth Avenue brand.

Private-equity firms have only recently regained their appetite for retailing. Blackstone Group, Thomas H. Lee Partners, Kohlberg Kravis Roberts and Bain Capital all bid for Neiman. “Retail is the investment du jour,” says Larry Kaplan of Corporate Solutions Group, an investment bank. Private-equity firms currently have billions of dollars they are eager to spend.

What makes this deal different is that it is not a turnaround or a fixer-upper. Neiman is already in great shape. Last year, through just 37 outlets, it earned profits of $205m, almost double the year before. Sales rose by 14% to $3.55 billion. Although mid-market department stores are at saturation point, the luxury-goods business is thriving. Not only are the rich getting richer, but also the number of rich people is growing. American households with a net worth of over $1m jumped by 33% last year to 8.2m, according to TNS Financial Services. The average annual income of Neiman's shoppers is around $500,000.

This, plus its rapid recent growth, explains Neiman's appeal to investors, who can also expect to profit by borrowing against its cashflow. Stephen Hoch, a professor at Wharton business school, calls Neiman a “cash-generating machine”. But its high price relative to profits requires it to keep growing fast. Ominously, Standard & Poor's, a credit-rating agency, fears that Neiman's growth rate is not sustainable.

Burton “Mr Luxury” Tanksy, Neiman's boss, has been careful not to dilute its brand by growing too fast. He planned to open seven new stores by the end of 2008, which may not be aggressive enough for the new owners. Neiman may now expand overseas, where its brand name already has cachet—a move not without risk.

There are no plans to change the existing management. But top executives at Neiman were recently given “golden parachute” severance deals, in case things do not work out with the new owners. Richard Smith, Neiman's chairman, and his family, with a 12.7% stake in the firm, will get nearly $650m from the sale.

Property may have also played a role in the acquisition. Neiman owns choice real estate in wealthy places such as San Francisco and Houston. Kmart saved itself two years ago by selling off property.

Even so, many observers reckon that Neiman's price was too high. Its new owners must hope that demand for $3,100 Manolo Blahnik alligator pumps, $50,000 Fabergé eggs and $1.5m “his-and-her” bowling centres (lessons from a pro bowler are extra) does not wane too soon.

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Chief executive succession

Bad heir days

May 5th 2005
From The Economist print edition

In France, as elsewhere

WHY are large firms with thousands of staff so bad at selecting and grooming one of their number to be their next boss? The Centre for Creative Leadership reckons that 40% of new chief executives fail within their first 18 months. Corporate bosses are departing with such frequency that if the length of their reign continues to fall at the current rate, estimates Booz Allen Hamilton, a consultancy, by 2042 the average boss will be in office for less than a day.

Unlikely perhaps, but it illustrates a sustained and widespread phenomenon. This week, in France, the heir apparent at Saint-Gobain, a big glassmaker, resigned. Christian Streiff had been the anointed successor for a mere 13 months. An insider was quoted as saying, “A good cardinal does not necessarily make a good pope”. But for 26 years Mr Streiff had been with a firm known for nurturing its staff, and for several of those years he had been in cardinal-level roles. He never made pope.

Last month Philippe Germond, the heir apparent at another big French company, Alcatel, resigned. Unlike Mr Streiff, he was an outsider, lured from Vivendi Universal to be Alcatel's chief operating officer in January 2003. Outsiders are more risky than internal candidates. In Europe in 2003, 70% of departing chief executives who were outsiders had been pushed, compared with 55% of departing insiders. In part, this may be because they are also more likely to be called into troubled firms (as Alcatel then was, along with other telecoms-equipment makers) and to be paid more.

Both French firms have chosen an insider as their next dauphin: at Alcatel, the British-born Mike Quigley, who joined the group in 1971; at Saint-Gobain, Pierre-André de Chalendar, who joined the company as a corporate planner in 1989. Both firms currently have powerful chief executives who are eager to leave an imprint after they have gone. At Saint-Gobain, the board unanimously chose Mr de Chalendar, “acting upon the recommendation of chairman and chief executive Jean-Louis Beffa”. At Alcatel, the long-serving Serge Tchuruk, also chairman and chief executive, had made it clear that he was not prepared to pass the reins to Mr Germond.

An article in the most recent *McKinsey Quarterly*, a magazine published by the consulting firm, argues that “leaving the succession to the incumbent chief executive is a high-risk strategy”. Only 11% in a survey of international recruiters published this week by one of them, Korn/Ferry, thought that the incumbent chief executive should be in charge of succession planning. This is better left to a committee of independent directors who will have to live with the consequences of their choice.

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Russian oil

King Solomon's pipes

May 5th 2005 | MOSCOW
From The Economist print edition

The benefits of keeping Japan and China guessing

CONFRONTED by two women laying claim to the same baby, King Solomon threatened to cut the child in half—then gave all of it to one of them. Perhaps someone in Moscow has read the fable and decided to reverse it. Confronted by two suitors for a planned oil pipeline, the Russian government has opted to cut the line in half and give it to neither.

Japan and China have long been lobbying to be the main beneficiary of a pipeline to carry Siberian oil eastwards. Both want to reduce their reliance on Middle Eastern oil. China's demand is soaring, and its dependence on maritime imports worrying (some Russian oil already goes to China by rail, though most exports flow west). Like India, China has been seeking a stake in assets expropriated from Yukos, a Russian oil firm being reconstructed.

The proposed Chinese route is shorter and far cheaper. But it was tarnished by association with Mikhail Khodorkovsky, Yukos's ex-boss, who once hoped to break the state's pipeline monopoly and build a private one from Angarsk to Daqing (see map). That aspiration may partly explain Mr Khodorkovsky's current predicament (the postponed verdict in his politicised trial is expected on May 16th): in Russia's energy-dominated economy, a private pipeline would be tantamount to privatised foreign policy. The Japanese option—a route to a port on the Sea of Japan—would allow exports to South Korea, America and China too, rather than to a monopsonistic customer. Japanese finance would help to defray the much higher costs of what would be a gargantuan 4,000km (2,600 miles) project.

Eventually, late last year, after much prevarication, what seemed to be a final decision was announced: the pipeline would be built to the Sea of Japan. China would have to focus on Kazakh oil instead. The details would be cleared up later. Yet when the government's instructions to Transneft, the pipeline monopoly, were released last week, some of the details were missing. An oil port is supposed to be constructed at Perevoznaya—an odd choice, given the disruption it will cause to the habitat of a rare leopard. But the schedule for pipeline construction, to be done by the end of 2008, refers only to an initial section from Taishet to Skovorodino—a stone's throw from the Chinese border.

The Japanese say that they would be content for the Chinese to get a spur from the main pipeline, but

insist that their branch be built first. They fear that without priority commitment to their route, the largely untapped east Siberian oil reserves will remain just that. In short, if their branch is not built first, it may never be built at all.

The smart money in Moscow now says that the pipeline will head south from Skovorodino first, and that Japanese fears may be realised. (A mysterious multi-billion-dollar transfer from China that was not, repeat not, used to help Rosneft, a state-owned oil company, buy Yukos's prime production asset in December, may have been decisive.) Other ways to increase Russia's oil-export capacity, such as a pipeline to the Barents Sea, may yet take precedence over the Perevoznaya plan. The leopards may not suffer after all.

What explains these goings-on? Confusion and paralysis in government may be part of it. But in the extra time they now have to make a final, final decision, the Russians can continue to wring concessions from the two suitors: in bilateral talks, such as an ongoing territorial dispute with Japan, or to raise support for Russia's bid to join the World Trade Organisation. The Russians, says Stephen O'Sullivan of United Financial Group, a Moscow investment bank, are taking a “short-term tactical approach to an issue that both its potential partners view as strategic.” It seems that oil-thirsty Asian countries, like ambitious western energy companies, have little choice but to court the Kremlin.

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Apple Computer

The obsessiveness of Steve Jobs

May 5th 2005 | SAN FRANCISCO
From The Economist print edition

The most successful paranoid in business history?

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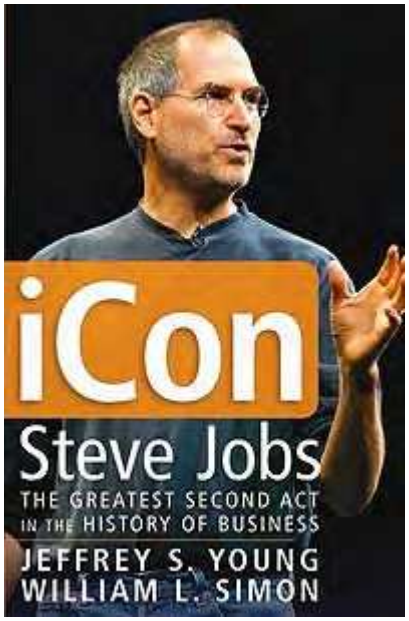

iUnauthorised

"APPLE is firing on all cylinders," beamed Steve Jobs, its boss, the other day, as he announced another stunning quarter: revenues up by 70% on the same period a year ago; profits up by 530%. As for coolness, Apple remains off the charts. The iPod, its portable music-player, seems unstoppable. Such is its "halo effect" that Apple's computers and laptops are winning market share (admittedly, from a small base of 2.4%). And, two decades after launching the personal-computer revolution, it is Mr Jobs who continues to push it furthest. On April 29th, Apple released Tiger, its latest operating system. The cognoscenti queued for several blocks around Apple's flagship store in San Francisco to get it.

All of this draws attention, yet again, to the greatest mystery about Mr Jobs: why, amid all this success, is he so prickly? As members of the "cult of Mac" lined up outside Apple's 105 stores, inside his staff removed all books from John Wiley & Sons from the shelves because the publisher is daring to release a biography of Mr Jobs. Never mind that the book—"iCon: Steve Jobs, The Greatest Second Act in the History of Business", by Jeffrey Young and William Simon—is, by all accounts, hugely positive about Apple's boss, and hardly pathbreaking. To Mr Jobs, all that seems to matter is that it is unauthorised.

This is a pattern. Apple is suing several of its most ardent devotees for running what are, in effect, fan websites specialising in Apple gossip. A Harvard freshman who runs the website Think Secret stands accused of seducing Apple employees into breaking their confidentiality agreements and divulging interesting titbits. People behind several other Apple sites are charged with peddling "trade secrets". There are also many accounts of Mr Jobs shouting at employees, journalists and occasional civilians caught in the crossfire.

All of which seems decidedly odd. Bill Gates, the boss of Microsoft and Mr Jobs's nemesis by any ordinary measure of business success—he is the one with the operating-system monopoly, after all—would kill to get Apple's enthusiastic product reviews. Microsoft has been pouring sums that Apple can only dream of into developing the latest version, called Longhorn, of its own operating system, Windows. The keystone of this was supposed to be a new approach to storing and finding data, to replace today's metaphors of "files" and "folders" (which were introduced by Apple, not Microsoft, in the 1980s). The effort failed, and Longhorn will not only be late—it is not expected for another 18 months or so—but will fall far short of its original ambition. Instead, it is once again Apple that seems to have cracked the problem, with Spotlight, a new feature in Tiger that allows users to locate anything on their computers, and "smart folders" that appear to build themselves.

Mr Gates takes time to talk to journalists and puts up with their abuse; the press usually agrees that he is geeky and bullying. Mr Jobs is as media-friendly as an apparatchik in Communist China; the press considers him cool. But, goes one theory, this may be deliberate: Mr Jobs, a marketing genius, intuitively understands how to build suspense out of dark paradox. Well, who could accuse Mr Gates of that?

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Boards and bids

Down to the wire

May 5th 2005
From The Economist print edition

MCI sells itself to Verizon for less than Qwest offered

“NOT the greatest day for corporate governance,” says Bruce Berkowitz, the boss of Fairholme Capital Management, which owns around 3.5% of MCI, a floundering telecoms firm that on May 2nd decided to accept a purchase offer from Verizon that is 13% less than a bid by Qwest. “The MCI board,” says Leon Cooperman, the head of Omega Advisors, which owns over 3% of MCI, “cost all the shareholders some money.”

After four months of bids, counter-bids and vitriol, MCI for a fourth time spurned an offer from Qwest, the latest worth $9.8 billion, in favour of one from Verizon, which had been forced to increase its original offer by 25% to $8.5 billion. Qwest then withdrew its bid, citing a “process that seems to be permanently skewed” against it by MCI, and an “example of that board's failure to accept the offer that maximises shareowner value”.

In opting for the lower offer, MCI cited two main reasons: the relative financial strengths of the suitors, and that large customers (unidentified, even to big shareholders) said they preferred Verizon and might quit MCI if it were owned by Qwest.

MCI, formerly called WorldCom, emerged from bankruptcy protection last year after an $11 billion accounting fraud, the biggest in corporate history. Verizon is a less risky partner. It has a market capitalisation of around $96 billion, is profitable and has a lucrative wireless unit. Qwest, meanwhile, has a market capitalisation of around $6 billion and a massive $17 billion of debt, and lacks a wireless arm. In its quarterly earnings this week, the firm's revenue declined and it only eked out a small profit because of asset sales.

Together, Verizon and MCI are well placed to compete against a combined SBC-AT&T, as America's telecoms market consolidates. MCI's chairman, Nicholas Katzenbach, acknowledged that the board chose “from the standpoint of risk versus reward.” Yet in so doing, it implicitly placed what it considered the long-term interests of the firm ahead of the immediate interests of owners. This may seem to represent an enlightened form of business strategy, but it raises thorny questions.

MCI shareholders are hardly widows and orphans; anyone with the stomach to invest in an unprofitable firm emerging from bankruptcy in an ailing industry is clearly willing to assume risks in return for rewards. Going with Qwest would be just another tummy-churning swerve on the roller-coaster ride—something many big shareholders said they wanted.

The deal must still be approved by MCI shareholders; a vote is expected this summer. Even if linking up with Verizon makes good business sense, the MCI board's refusal to take seriously alternative options reflects poorly on it. After all, if it were not for the persistence of big shareholders and of Qwest, MCI's board would have accepted a far lower price than shareholders will now receive. As Mr Berkowitz says, “the board obviously feels responsible to all stakeholders, whereas it is my opinion that the board is serving at the pleasure of the shareholders.” Quite so.

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Kosher tours

Moses never had it so good

May 5th 2005 | MIAMI
From The Economist print edition

A holiday with a difference

ABOVE the beach in Miami, a plane pulls a message for the sunbathing masses: “PASS. BASH 2NITE AT JIMMY Z'S 10PM K FOR P”. For the thousands of Jews who came here for Passover this was code for kosher clubbing. There were other signs that all was not *treif* in the one-time vice capital: the boardwalk bustled with men wearing *yarmulkes* and modestly dressed women pushing prams; resort pools teemed with countless children.

This year, around 50,000 people spent a combined $175m on an American kosher-for-Passover package holiday, says Menachem Lubinsky, editor of *Kosher Today*, a trade paper. This is up from 42,000 in 2004. Some 85 hotels participated, in places such as Arizona and Hawaii, plus overseas resorts and cruise lines. Guests typically stay for the week, paying $1,500 to $10,000 each, eating their kosher meals (and an abundance of snacks) at the hotel.

A kosher tour is a luxurious alternative to the hassle of scouring one's home for the holiday period to remove all traces of leavened products, in remembrance of the haste of the Jewish exodus from slavery in Egypt, which left no time for bread to rise. Traditionally, women are stuck with this grunt-work. As more of them enter the workforce their extra income and limited time make good reasons for a getaway, explains Rabbi Moshe Elefant of the Orthodox Union, the largest kosher-certification agency. High-end catering, which can include vast buffets of seared tuna, caviar and spare ribs, makes the holiday's dietary restrictions remarkably palatable.

Yet a glut of new operators has created serious competition, and overheads are high, says Dan Frucher of Leisure Time Tours, which has offered Passover packages for nearly 40 years. Besides the expense of marketing, food costs continue to rise, as patrons demand finer menus. Staff costs can be huge. Lasko Family Kosher Tours, a leading operator, hired nearly 2,000 people to serve some 6,000 guests this year. Arlene Lasko, who formed the firm with her husband Sam, expects revenues of $9m-10m, but laments that “profit doesn't hit anywhere near there. We'll make 5% of that, if we're lucky.”

Resorts want the business, especially at a time of year when conventions are rare, though some have been burned by less professional tour firms. Now hotels typically want guarantees, and a big deposit up-front. But there are no complaints at the Eden Roc, a luxury resort in Miami, which rented to Lasko for the eighth year in a row, filling all 349 guest rooms for nine nights during a slow season. Where better to meditate on liberation than by the lapping waves of the ocean, while getting a tan?

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Face value

Last stand at Morgan Stanley

May 5th 2005
From The Economist print edition

Landov

How much longer can Philip Purcell survive as boss of the Wall Street giant?

APART from his famously loyal board of directors, the Phil Purcell fan club has long included senior executives at rival firms who believe that he has opened up an historic opportunity for them to knock Morgan Stanley off its high perch. Nothing that has happened in recent weeks has dampened their enthusiasm. The growing demand for Mr Purcell's head from many of his staff, a group of eight high-profile former executives, and a rising number of institutional investors has been answered by a steady march of executives out of Morgan Stanley's doors that is stunning even in an industry known for high turnover. Headhunters are buzzing around the firm. Workers who are not being enticed oscillate between feeling envious and lavishing fond farewells on friends who may soon be well placed to hire them.

As for those who choose to stay, there may never have been a better time to demand better terms. Many of the firm's star investment bankers have come to believe that their contributions are not being reflected in their bonuses because other bits of the business, notably the Dean Witter brokerage operations which Mr Purcell once ran, have done poorly. If bankers and traders excel at anything, it is exploiting their leverage. This year the results of many of Wall Street's investment banks may well be determined by how wisely they exploit Morgan Stanley's brain drain.

As if all of this were not enough for Mr Purcell to worry about, on May 3rd Morgan Stanley disclosed, as part of its response to another lawsuit, that it had found e-mails that it had previously said were destroyed during the terrorist attacks on September 11th 2001. These would have been examined as part of the broad inquiry by regulators into allegations of fraudulent research by Wall Street firms. Despite underwriting many of the internet share offerings that later turned sour, Morgan Stanley avoided the harsher penalties imposed on its rivals because no incriminating e-mails were found—a fact about which Mr Purcell has been known to gloat. Finding these e-mails now is embarrassing enough. If they contain material that is incriminating, or can be read that way, Mr Purcell's job will get even harder.

Lately, movements in Morgan Stanley's share price have seemed highly correlated with the market's view of whether Mr Purcell will survive as boss—a position that has been his alone since January 2001, when he forced out his co-head, John Mack, in a boardroom coup. Morgan Stanley's share price rose on Friday April 29th, with rumours that the board would fire Mr Purcell during a weekend meeting, then fell sharply on Monday when Mr Purcell, yet again, received his board's endorsement. But even while Mr Purcell remains, a floor under the share price is being provided by speculation that he will arrange a face-saving

exit for himself by selling the bank. HSBC and Bank of America are both likely buyers. And J.P. Morgan, given time to improve its own performance and share price, would surely like to reunite the firm that banking laws tore apart in the 1930s.

Meanwhile, Mr Purcell faces the huge challenge of steering Morgan Stanley out of its current crisis when many of its problems seem to stem from his continuing presence at the helm. True, the firm is not (yet) in terrible shape. Indeed, it is highly profitable. But it is hard to find anyone who believes that he has done a good job—apart, that is, from Morgan Stanley's directors, who recently awarded Mr Purcell a $22m salary, up from $14m the year before. His reluctance to talk to the press reflects a general remoteness, not helped by his frequent trips home to Chicago, where his seven sons were raised. He suffers the lack of self-doubt common in former McKinsey consultants. His management style is autocratic and bureaucratic. At the age of 61, he is unlikely to change. His roots in low-end Dean Witter's brokerage made him unpopular with Morgan Stanley's haughty investment bankers from the day the firms merged in 1997.

In a business that revolves around people, the executives whom Mr Purcell has either sacked or encouraged to leave are far better known inside, and outside, the firm than he is himself. Morgan Stanley retains an enviable position in investment banking but each defection adds to doubts about whether it can be sustained. And the businesses that Mr Purcell brought to the merger are either troubled (brokerage) or lagging (credit cards).

A random walk down Wall Street

So far, Mr Purcell has made two moves in response to the criticism—neither of which has done much for his reputation or prospects of survival. Eight years after the merger, he has finally decided to integrate brokerage into the investment bank. The kindest interpretation is that Mr Purcell takes a long time to make a decision. A more cynical one is that the move is an attempt to avoid admitting that his original vision of combining his brokerage operation with Morgan Stanley never made sense and should be undone. His second move is to decide to spin off the Discover credit card, which has steadily been losing market share. Although placing Discover in more capable hands makes sense from an operating perspective, it would also remove a consistent source of profit that has provided stability during rocky moments in the financial markets. That has unnerved the credit-rating agencies and raised the possibility that Morgan Stanley's funding costs—a crucial expense—may rise.

But what other options does Mr Purcell have? His record, and his firm's relatively depressed share price, would make it hard for even a board as docile as Morgan Stanley's to endorse any other move short of a sale. Mr Purcell's best hope is that a surge in initial public offerings of shares and in trading will boost Morgan Stanley's profits, and disarm his critics. On the other hand, a sharp downturn in the markets, or a serious investigation resulting from Morgan Stanley's e-mail find, would put serious pressure on the board to dump Mr Purcell. Sometimes things have to get really bad before they can get better.

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German capitalism

Locust, pocus

May 5th 2005 | FRANKFURT
From The Economist print edition

FLPA

Some German politicians want to blame international business and finance, not themselves, for the country's sluggish economy

Get article background

MANY of Germany's roughly 5m unemployed, and thousands of others whose jobs seem daily under threat, have understandably been looking for someone to blame for their plight. An economic-reform programme launched in March 2003 does not seem to have turned things around much. In fact, forecasts last week halved previous estimates for GDP growth this year to a mere 0.7%.

So when Franz Müntefering, head of the SPD, the leading party in Germany's governing coalition, found a scapegoat last month in the form of “international capital”, there was a spontaneous cheer from at least half the population, and furious rebuttal from business leaders and right-wing politicians. Mr Müntefering attacked the behaviour of certain financial firms whose profit-maximising strategies were a long-term threat to “our democracy”. He described them as “swarms of locusts that fall on companies, stripping them bare before moving on.”

This is all good rabble-rousing stuff in the run-up to a crucial election in North Rhine-Westphalia on May 22nd. (Chancellor Gerhard Schröder has so far kept out of the debate, but is undoubtedly listening with interest.) But it has actually touched a deep national nerve. This has to do with the painful transition that Germany is making from a social market economy, in which firms and services were supposed, at least publicly, to be run by consensus for the “general good”, to the starker mechanisms of the market and shareholder value. Competition from abroad, and especially from new EU members in central Europe, is driving this change in part. But the biggest factor is Germany's persistent economic malaise.

The social market economy is still hallowed by politicians, but it survives only in fragments: for example, in the two-tier structure of German companies, where the workforce is represented on the supervisory board; in the role of workers' representatives in even the smallest companies; and in collective wage agreements. A reform in January this year, called Hartz IV, controversially punched a hole in the social safety net, ending generous benefits for the long-term unemployed and penalising those too picky about job offers or who have working partners.

Hartz IV so far has brought only more woe: it has added to the social-services bill and unemployment has hardly fallen (see chart 1). Moreover, this year and last have been full of bad news from big employers: Volkswagen, DaimlerChrysler and Opel (a German subsidiary of General Motors), KarstadtQuelle and others have cut thousands of jobs. Wages have been forced down or frozen by companies threatening to relocate abroad. Even Deutsche Bank, despite rising profits, has been laying off staff, inviting the particular wrath of Mr Müntefering. “The economy (ie, big business) must realise,” he railed, “that it exists to serve people and not the other way round.”

The public are angered by the fact that big German companies are beginning to make record profits again, after three bad years, and have achieved that by cutting costs, particularly their wage bills, and by reducing investment, especially in Germany. Last year the 24 top industrial companies reduced their investment in Germany by 20%, and worldwide by 10%, according to *Handelsblatt*, a business daily. At the same time they increased their dividends and payouts to shareholders by 40%. So there is an impression that companies are rewarding their owners, but not cosseting their workforce as they did in the past—they are, in other words, adopting an increasingly Anglo-Saxon approach.

The debate raging in Germany is about whether the country is quite ready for this kind of capitalism rather than the more socially oriented Rhineland variety that is ailing, but not quite buried. Mr Müntefering is clear where he stands: “We want social market economy, not market economy pure.” But despite the populist bent to his rhetoric, not everyone supports his stance. Attending a rally on May 1st he was ritually pelted with eggs by trade unionists who are supposed to be his friends. Many people have told him in the past three weeks that what he wants just will not work any more, and that opportunistic foreign investors, far from being locusts, can be the reformer's friend.

Not child's play

Take the Children's Investment Fund (TCI), a hedge fund that has been making headlines because of its activism as a shareholder of Deutsche Börse, a financial exchanges group. Armed with an 8% stake accumulated in January, TCI spoke up against Deutsche Börse's attempt to buy the London Stock Exchange (LSE), saying that buying back shares would be a much better use of its spare cash. Rolf Breuer and Werner Seifert, respectively chairman and chief executive of Deutsche Börse, at first dismissed TCI as an opportunist that had no right to influence the firm's strategy.

But TCI was not the only disgruntled shareholder. Others, some of whom could scarcely be called short-term, were dismayed by the management's failure to consult shareholders before such a big takeover. A slanging match between Mr Seifert and Christopher Hohn, who runs TCI, resulted in Mr Hohn calling for a vote of no confidence in the supervisory board and for the removal of Mr Breuer as chairman at the next AGM on May 25th.

Mr Breuer, who is also chairman of Deutsche Bank, is almost the personification of Germany's old-style capitalism. He used to be Deutsche Bank's chief executive, so the fact that he holds the bank's chairmanship already offends one principle of corporate governance recommended by the European Commission. He has survived several gaffes that would have unseated a chairman in an Anglo-Saxon environment. Perhaps his biggest was not to recuse himself when it emerged that his bank was both

adviser and financier of Deutsche Börse's bid for the LSE, a conflict of interest of heroic proportions.

If not for TCI, Deutsche Börse might still be attempting an LSE takeover, without knowing or caring whether it had majority shareholder support. Yet the knee-jerk reaction of Hans Eichel, the German finance minister, to this corporate-governance row, was to threaten new laws against short-term profiteers—a threat he sensibly modified the next day, although this week he pointedly attacked TCI for disrupting Deutsche Börse's strategy.

Yet it should be clear, even to the most socially minded in Germany, that the clock cannot be turned back without inflicting enormous damage on the country's prospects. Germany has signed up to EU treaties that prescribe the free flow of capital across national borders. Repudiating these is impossible without leaving the EU. The same applies to taxing foreign-exchange transactions or introducing a minimum holding period for an equity investment—both recent suggestions. Hedge funds and private-equity funds have open access for the long or short term.

It is true that foreign private-equity funds have been the most active players in restructuring corporate Germany in the past two years. Their methods are often unsentimental, to say the least. Costs and staff can be slashed, equity is quickly turned into high-yield debt, and a positive return is sought sooner rather than later. The effect on a company's culture can be traumatic. Life in the boardroom and on the shop floor (for those who still have a job) is never the same again. Performance targets and personal assessments can radically change the atmosphere.

However, it is hard to argue that this is a bad thing when the former model has clearly become uncompetitive. The alarming aspect, for those who would like some elements of German corporate culture to survive, is that there is no alternative for the time being. There is no process of renewal whereby companies whose management becomes fossilised are replaced locally by new risk-takers. Private-equity firms have sometimes been the only bidders when German companies, or divisions of them, have been up for sale.

In the past two years private-equity firms have often sold their German investments to other private-equity funds—so-called secondary sales—for want of other buyers. The usual option of an initial public offering is rarely available. Burned by the stockmarket bubble of the late 1990s, German investors are mostly not buying equities these days. It seems that trade buyers—companies in the same or a related industry as the target—have also temporarily lost the risk appetite or the financial fire-power to compete.

In a parallel development, foreign buyers are frequently the only bidders for portfolios of non-performing loans that undercapitalised German banks have been keen to sell. It is a simple game of buying the loans at a deep discount and then collecting the collateral pledged against them, but few German banks have had the nerve or the spare cash to play it. Fortress, Lone Star, and Goldman Sachs have been among the buyers. Only Dresdner Bank, among those stricken with bad loans, had the resources to create its own loan-restructuring unit.

Bidding for Germany

Private-equity firms have funds behind them and the skill to leverage a company that they have bought (that is, to load it up with debt) and to achieve a quick return on the capital they have committed. But it is pointless to blame them for taking the opportunity, even though it may cost jobs inside Germany, or for repatriating their profits. The only intelligent response is to reverse the trend by outbidding the foreigner. That happened recently when Siemens, Germany's giant electronics and engineering group, fought off two rival private-equity bidders to buy Flender Holding, a maker of gears for industrial engines. More often, however, there is little or no competition.

The mistake made by Mr Müntefering and his supporters is to believe that the government can do much more than cheer, or jeer, from the touchline. As a stop-gap measure the government plans to lower the corporate tax rate, in a bill to be presented this week, from 25% to 19%, to give companies more incentive to create jobs at home rather than abroad. But that is clearly a response to the flat-tax alternatives that are on offer in central Europe.

And it will take more than that. What appears to be missing, except among Germany's cadre of internationally minded companies, is a combination of entrepreneurship and a willingness to take risk. Companies buying back shares, rather than investing in expansion, in an environment in which younger entrepreneurs are few and far between, offer a sign that domestic entities are running out of ideas.

The government is right to be concentrating on education and innovation to foster new business. But that is a long-term programme that cannot address today's crisis. Germany's misfortune is that its federal government cannot implement today what it thought of yesterday or even two years ago. Take the initiative to improve Germany as a financial centre. In 2003 plans were proudly unveiled to introduce alternative investments (hedge funds) to Germany; to kick-start a big programme of asset securitisation; and to introduce American-style real-estate investment trusts (REITS). None of these has happened, either because of legal obstacles or the fear of creating tax loopholes.

Even a tax amnesty, declared for German residents who have salted away an estimated €300 billion-500 billion ($390 billion-$640 billion) of their savings in Swiss bank accounts, Luxembourg funds and other tax havens, has garnered a mere €1.2 billion of extra tax. The poor showing was due partly to tax dodgers' fears that despite owning up they would still somehow be stigmatised. But the main reason is the poverty of investment alternatives in Germany.

For foreign investors, including hedge funds and private equity, the local apathy has been their opportunity. Mr Hohn of TCI believes that Deutsche Börse is far from being alone: shares of many other companies are trading at a discount because of the perception among investors that these companies are poorly governed. The prospect of better management coming in, or even just of bad management being thrown out, will raise their share prices. This is precisely what has happened in the case of Deutsche Börse: since Mr Hohn started making a fuss its share price has risen from €45 to €60.

The car industry provides two more opportunities of this kind: at DaimlerChrysler, whose shareholders are disgruntled with Jürgen Schrempp, the carmaker's chief executive; and at Volkswagen, in which the state of Lower Saxony has 18% of the voting rights and two seats on the supervisory board, and voting rights are capped by law at 20% per shareholder. The sniff of a real change in the status quo would lift the share price in both cases.

Mr Müntefering, after his blunderbuss attack on “international capital”, has little to offer by way of remedy. He would like to see more companies comply with a requirement of the voluntary corporate-governance code, which is to disclose individual executives' salaries: ten of the 30 big firms in the DAX stockmarket index insist they will give only an aggregate figure for the board. But the entire dismantling of the old boy network would be more to the point, and there are no signs of that happening on the supervisory boards of Germany's big companies.

Mr Müntefering would also like to see incentives for firms to create jobs rather than just to maximise profits. That is being discussed in the aftermath of a “jobs summit” held by the government on March 17th. The population's fear of job losses increased sharply after ten more countries joined the EU a year ago. Workers feel threatened not only by the relocation or outsourcing of production by German companies to central Europe, but also by the influx of cheap labour at home. Some occupations such as farming and building are specially protected for the next six years, and the government last week proposed extending this buffer to more types of labour. The protection would set a de facto minimum

wage for each occupation. But a minimum wage could be a two-edged sword. The success of the social-security reform, Hartz IV, depends on subsidising the unemployed to accept low-paid jobs (in some cases for one euro an hour) as a way back to work.

The government's deliberations over such social and economic engineering have been slow and inconclusive. Even if it does act boldly, it may have real difficulty in getting any radical proposal through the Bundesrat, the opposition-dominated upper house of parliament.

So the forecasts for German economic performance in the short term remain gloomy. The half-yearly assessment by Germany's six leading economic research institutes predicts a growth rate of only 0.7% of GDP in 2005, followed by 1.5% in 2006. The unemployment rate, which it puts at 11.1% this year, up from 10.2% in 2004, will sink to 10.4% in 2006, it says (but the Hartz IV reforms, which from this January merged benefits for the long-term unemployed with those on social security, make historical comparisons difficult). The subsidy of low-paid jobs, the report says, is actually frustrating efforts to increase job mobility and flexibility.

Pest controls

Perceptions that the reform programme, Agenda 2010, which the government has so far doggedly stuck to, may still not be producing results, are a drag on the SPD as it heads into the most crucial regional election before the general election due in the autumn of 2006. Hence Mr Müntefering's rallying cry and his selection of a scapegoat. Embarrassingly for him, his private hitlist of “locust” companies was discovered and published: it had Goldman Sachs, an American investment bank, at the top, followed by Deutsche Bank and a string of private-equity firms. Such apparent naivety has allowed the opposition, and conservative business leaders, a chance to rubbish Mr Müntefering and the rest of the ruling SPD. Edmund Stoiber, the prime minister of Bavaria, jeered sarcastically: “That kind of criticism means you would actually have to close the domestic market and erect national borders again.”

Norbert Walter, chief economist at Deutsche Bank, believes that Mr Müntefering has done enormous damage to his own party: there are no quick fixes, either to win the election or to solve Germany's economic problems. Mr Walter advocates patience while the Agenda 2010 reforms are given a chance to work.

In the meantime, international investors remain the prime moving force in Germany's drooping economy. They are forcing some change in a Germany which needs more of it, despite Mr Müntefering's efforts to put the clock back.

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European Central Bank

Making a point

May 5th 2005
From The Economist print edition

AFP

Despite sluggish growth and low inflation in the euro area, Jean-Claude Trichet, president of the European Central Bank, is in no mood to cut interest rates. Why?

EVERY now and again, the 18 men and women who set interest rates for the euro area hold their monthly meeting not at the European Central Bank (ECB) in Frankfurt, but somewhere else in the single-currency zone. This week was just such an occasion, with Berlin playing host on May 4th. Not that it made any difference: rates were held at 2% for the 23rd month in a row. In that time, the ECB has watched America's Federal Reserve raise interest rates eight times—most recently by a quarter of a percentage point, to 3%, on May 3rd.

Politicians in the ECB's host country might have hoped that a trip across Germany would prompt the central bankers to spot what they seem to have missed on their Frankfurt doorstep: a supine German economy, which has grown by only 0.6% a year, on average, for the past four years. Domestic demand has not grown at all in that time. On April 29th, Wolfgang Clement, the country's economy and labour minister, cut his growth forecast for the year from 1.6% to just 1%, lamenting that the ECB's monetary policy failed to reflect the sorrowful condition of the euro zone's biggest member.

If anything, the ECB has seemed keen not to cut rates but to follow the Fed up. Yet the euro area's economy keeps stumbling. On May 2nd, the Reuters/NTC purchasing managers' index for manufacturing fell below 50 for the first time since August 2003, implying that the sector is shrinking. David Walton, of Goldman Sachs, notes that a persistent reading below 50 has, in the past, been a cue for a rate cut. Nothing doing. “We are certainly not preparing for any rate cut. Not at all,” said Jean-Claude Trichet, the ECB's president, at the press conference after this week's decision.

Why not? Inflation is benign, and the markets expect it to remain so. Consumer prices rose by 2.1% in the 12 months to April, only just above the central bank's 2% ceiling, despite a surge in energy prices. Financial markets see no reason to doubt the ECB's commitment to price stability: yields on several euro-area governments' ten-year bonds have recently dipped below 3.5%. Households, according to the European Commission's surveys, are expecting more upward pressure on prices, although they are not acting on their doubts. Wage claims have been modest: pay rose by 2.2% in the fourth quarter of last year and by just 1.9% the quarter before. Nonetheless, the ECB dare not take its credibility for granted. A rate cut, Mr Trichet says, might undermine it. He insists instead on the need for “continued vigilance”.

A reputation to consider

Anxious about its credibility and reluctant to cut rates, the ECB, says Mr Walton, “risks fighting the last war.” The Bank has certainly been slow to decommission some of its old weapons. It still believes that targeting the supply of money, if only loosely, adds something to its fight against inflation, over and above targeting inflation directly. It sets a “reference value” (ie, a target it does little to meet) of 4.5% for the annual rate of growth of M3, a broad measure of the money supply that includes short-term securities and money-market funds as well as bank deposits and notes.

Money-supply growth has exceeded this reference value continuously since 2001. In the year to March, M3 grew by 6.5%. The ECB fears that this growing pool of liquidity might eventually be spent on goods, which could push up consumer prices, or property, which might inflate house prices. But this money could also disappear whence it came, returned to the banks and other financial institutions that created it, in exchange for less liquid assets.

The ECB believes that most of the euro area's woes are not monetary but structural

The ECB's defenders point out, quite reasonably, that at 2% interest rates are extraordinarily low. How much more accommodating can the bank be? However, the ECB's policy rate alone is not the best gauge of the stimulus it is providing. Robert Barrie, of Credit Suisse First Boston, uses a rule of thumb that shows that while policy is loose for some countries it is tight for others—much as you would expect in a 12-member zone. He compares the ECB rate with the rate of nominal GDP growth. In France and Italy, the euro area's second- and third-biggest members respectively, the money value of GDP is growing faster than the ECB's 2% interest rate, suggesting that monetary policy is pretty loose. Outside Germany, Mr Barrie points out, loans to the private sector are growing by more than 10% a year.

Inside Germany, however, lending is falling. The money value of Germany's output grew by only 0.9% in the last quarter of 2004, falling more than a percentage point short of the nominal interest rate. In no other G7 economy are monetary conditions as tight.

The ECB believes that most of the euro area's woes are not monetary but structural: it prescribes freer markets, not lower interest rates. Though more liberalisation would surely be welcome, Kevin Daly, also of Goldman Sachs, argues that the euro area still has some “room to grow”, even within its rigid frame. In its most recent forecast, the OECD predicted that the euro area as a whole would fall short of its full potential by 1.6% this year. Germany's output gap would be no less than 2.5%; those of the Netherlands and Portugal would be bigger still.

These estimates assume that unemployment in the euro area could fall to 8%, from 8.9% now, without generating inflationary pressures. That may be wishful thinking: in the last boom, wages started picking up as soon as unemployment fell to 8.5%. On the other hand, painful, if piecemeal, reforms of the labour market, such as the Hartz IV reform in Germany, may have changed this picture, by making it possible for the labour market to tighten without raising wage pressures.

Possible, but not inevitable. Whether or not Europe's job markets tighten depends on demand. Will total spending be enough to employ all those willing to work at the going rate? Seen from Berlin, the answer lies in Frankfurt.

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The American long bond

Resurrected?

May 5th 2005 | NEW YORK
From The Economist print edition

An old favourite may return

WHAT a difference a deficit makes. When America's Treasury stopped issuing 30-year bonds in October 2001, the optimists in government thought the federal budget was set for eternal surplus. Now, with the deficit projected to reach $427 billion this year and not much less next, the fiscal machismo is gone. It makes sense for the government to lock in today's interest rates—still low, although the Federal Reserve raised them again this week—for as long as possible. Where Europe led (both France and Britain are going for 50-year bonds), America looks disposed to follow.

On May 4th, the Treasury said that it would ask its private-sector advisory panel for their views on the matter. If these views are favourable—and they are expected to be—twice-yearly auctions of $20 billion-30 billion a year could begin as early as next February. The price of existing long bonds, buoyed by their scarcity, promptly fell.

Bringing back the 30-year will make institutional investors happy too. There is unmet demand for long-dated paper, says the Bond Market Association, an industry body. That is one reason why the yield curve has stayed pretty flat despite the Fed's repeated tightening of short-term rates. As Americans age, and actuaries and accountants want pension funds to match their assets and liabilities more closely, long-dated bonds from an unimpeachable issuer look just the ticket. The recent boom and bust in the equity market scared many.

Some argue that long-term investors' real enemy is not the mild mismatching of assets and liabilities but inflation, against which equities are a better hedge than long bonds. Inflation-linked bonds are one answer, but these typically yield little and, in America, are said to lack liquidity. So the 30-year bond will be welcomed back, but the search for other long-term investments will continue.

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Berkshire Hathaway

Preaching to the converted

May 5th 2005 | OMAHA, NEBRASKA
From The Economist print edition

Warren Buffett weaves his old magic, but there are troubles in store for what is arguably America's most successful investment company

HE IS known as the “Sage of Omaha” for good reason. Warren Buffett is as engaging on television as he is at his own hugely popular AGMs. Interviewed on CNN on May 4th, he ranged over broad themes that preoccupy him increasingly: America's trade deficit, nuclear terrorism, Social Security and taxes. He said less about the specific issues—the state of the insurance business and his own advancing years—that weigh on Berkshire Hathaway, the investment firm that he has transformed over four decades from a rocky New England textile producer to one of America's largest public companies.

Berkshire Hathaway is a curious beast, and not only because its performance has beaten that of the S&P 500 in all but six of the past 40 years. Looking at its annual accounts is like opening a wardrobe and finding socks mixed in with suits. Its portfolio of financial investments consists of mainly big stakes in mainly American companies such as Coca-Cola, Wells Fargo and Gillette, as well as junk bonds (at times), foreign-exchange contracts (since 2002) and, increasingly, cash.

It also has a clutch of operating businesses, from insurance to home furnishings. No devotee of charts or efficient-markets theory, Mr Buffett steers by “intrinsic value” in choosing his investments. But the basis of his own fortune, said to be $40 billion, and the money he has made for his shareholders is “float”—cash churned out by some of the operating businesses to finance these investments. With its natural gap between premiums received up-front and claims paid later, insurance is the main source of float; long-tail reinsurance is particularly attractive. As long as risks are priced correctly when policies are written, the cash generated is better than free.

So the insurance business is central to Berkshire's fortunes; and insurance is looking none too robust these days. Some are predicting a downturn in property and casualty premiums later this year. But the immediate issues are regulatory. Berkshire and its subsidiaries were untouched by the first lot of investigations (into mis-selling and broker kickbacks). The current round centres on “finite-risk” reinsurance, which can help insurers, especially, smooth reported profits inappropriately. American International Group (AIG) is the seamiest, General Electric the latest company to fall under the regulators' gaze.

Berkshire's insurance operations have been caught up in three of these investigations; General Re, bought in 1998, plays a central role. One concerns reinsurance sold for years to a now-bankrupt professional-liability insurer in Virginia. The second involved selling financial insurance in Australia; once again, a failed insurer provided the catalyst. The third and most conspicuous turns on finite-risk reinsurance provided by General Re to AIG in 2000 and 2001 at the latter's urging. Other Berkshire affiliates are being roped into the last two investigations, and the Sage himself was summoned to Washington in April for questioning as a witness.

Each week seems to bring a new revelation from AIG. After the departure in March of Hank Greenberg, its chairman and chief executive, the giant insurer said that it would have to restate its net worth by about $1.7 billion as a result of these and other accounting fudges. On May 1st, postponing the deadline for filing its 2004 financial results with the Securities and Exchange Commission yet again—this time until May 31st—it suggested that a further $1 billion might be trimmed off net worth.

No one suggests a pattern of impropriety at Berkshire, but the investigations were on shareholders' minds at the company's AGM in Omaha last weekend. The issue will not go away: if anything, finite-risk reinsurance may spur questions about other methods that companies use to smooth reported

The insurance business is central to

earnings as well as about banks' or insurers' duty to see that counterparties use their products legally. Despite all this, General Re is still a good business, Mr Buffett thinks, because it is providing more than $20 billion a year in float. Its underwriting began to break even last year.

Berkshire's fortunes; and insurance is looking none too robust these days

Another question for Berkshire's adoring shareholders to ponder was succession. Who will keep the show on the road when Mr Buffett, now 74, and his vice-chairman, Charles Munger, 81, step down? Mr Buffett seems to be thriving on a steady diet of Coke, cheeseburgers and ice cream, and is in no hurry to go, but time waits for no man. Fitch, a rating agency, reduced the outlook for the AAA-rated firm to negative in April, giving as its main reason Berkshire's heavy reliance on Mr Buffett.

Mr Buffett is anxious to perpetuate Berkshire's “culture and character” by peopling its board with like-minded folk. Bill Gates, chairman of Microsoft, has joined the board in the place of Mr Buffett's wife, who died last year. Mr Buffett's successor is likely to come from within the firm and its operating businesses. There are said to be three front-runners, though different people give different lists of three. Mr Buffett says that in the next couple of years, given the good companies that he will be buying, there could be more candidates.

Yes, but what good companies? Berkshire's existing firms and investments are churning out more cash than Mr Buffett and Mr Munger know what to do with, and worthwhile acquisitions are proving hard to find. At the end of 2004 Berkshire was sitting on $43 billion in cash and cash equivalents; at the end of the first quarter of this year, it had a little more. Last month Berkshire bought a slice of Anheuser Busch, a brewer, and it talks of acquiring an insurer for less than $1 billion in the next few weeks, but big deals are elusive.

This may have much to do with Berkshire's sheer size. As other successful money managers have found, the bigger the fund, the harder it is to maintain high rates of return. Berkshire trailed the S&P 500 in 2003 and 2004, and has started this year with a $310m loss on a bet against the dollar. Mr Buffett has sat out markets he judged unpropitious before, only to pounce when they turned. Now he hints that unless he has a better idea in the next few years he will consider a “very substantial” payout to shareholders. Most would give a lot just to have him stick around.

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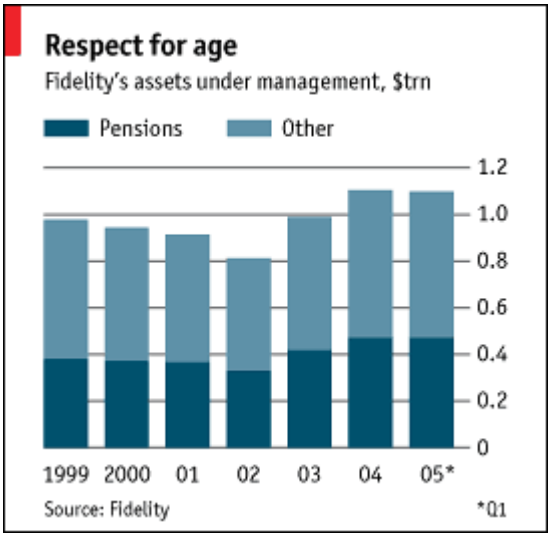
Fidelity

Maturing

May 5th 2005 | NEW YORK
From The Economist print edition

Abigail Johnson's new job reflects a shift in American fund management



FIDELITY has long been the bellwether for America's asset-management industry. In the bull markets of the 1960s, 1980s and 1990s, its roaring equity funds made it a dominant force; in the slump of the 1970s, it became a leader in dull but safe money-market funds. Its appointment on May 2nd of Abigail Johnson as head of retirement services marks another change of course. The future of America's biggest fund-management firm looks less exciting than the recent past, but it may be better for investors and, given Fidelity's sheer scale, for America's pension system.

Ms Johnson, daughter of Fidelity's chief executive and herself the largest shareholder, has held several jobs at the firm. Having been a modestly successful fund manager, she became head of fund operations in June 2001—and thus perhaps America's most important investor. On her watch Fidelity avoided the industry's worst regulatory scrapes and headlines. But whereas Fidelity's funds had been famous for thrilling investors, running (mostly) hot and (sometimes) cold, under Ms Johnson they rolled with the markets. According to Morningstar, a fund tracker, returns deviated much less from the market average than before.

Magellan, Fidelity's flagship fund—once run with spectacular success by her father, Ned Johnson—now waddles along behind the S&P 500 index, even before deducting management fees. The fund's assets, which once topped $100 billion, are down to $55 billion. Because such a huge fund will have trouble beating the market, shrinking it further may be wise.

Some even think that Fidelity's days as a hot investment firm are over. Sharp managers join nimble hedge funds, not mutual-fund behemoths. Some of the best tactics for large funds, such as investing in poorly-run companies and kicking out bad managers, are ones that Fidelity, with its many corporate clients, is loth to use.

Fidelity's prospects are better than this might imply. The new, duller Fidelity has built a business model bearing a resemblance to that of Vanguard, the industry's number two, but with even cheaper investment options and highly sophisticated, round-the-clock, customer service. Under Ms Johnson, Fidelity cut charges for retail index-fund investors to well below the opposition's. Bond funds, once a problem for Fidelity given its affection for risk, are now consistently good performers.

The mix of sound bond funds and cheap exposure to equities is a fine one for Ms Johnson's new customers, workers saving for retirement. These also supply the fastest-growing component of Fidelity's $1 trillion-worth of assets under management (see chart). Unlike conventional mutual-fund investors, who often seek dramatic returns, people making monthly contributions to private pension accounts, such as the 401(k)s offered by many American companies, will rely on diversification and compounding for long-run returns. Ms Johnson may never display the sizzle that brought fame to her father and life to her family's firm, but the time for pyrotechnics may be over.

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Italian banks

Machiavellian manoeuvres

May 5th 2005
From The Economist print edition

A Dutch bid for an Italian bank looks likely to be thwarted

A BIG, strong international bank and a small, debt-laden local rival are vying to take over Banca Antoniana Popolare Veneta (Antonveneta), Italy's ninth-largest bank by assets. The big bank made its bid first; its price is higher; and it is offering cash, which the small bank is too stretched to do. No contest, you might think. This being Italy, however, Banca Popolare di Lodi (BPL), the country's tenth-largest bank, will probably prevail over the much bigger ABN Amro, of the Netherlands.

The Dutch looked well placed to pull off Italy's first significant cross-border bank merger. Antonveneta's board had approved the bid; the European Commission had given the green light; and Antonio Fazio, governor of the Bank of Italy, had given ABN Amro permission to increase its stake in Antonveneta above 20%.

Meanwhile, BPL was pulling every string to frustrate the Dutch. By last weekend it had upped its stake in Antonveneta from 4.9% when ABN Amro launched its bid to 29%, just below the trigger set by Italian law for a mandatory cash offer for the rest of the shares. At a shareholders' meeting on April 30th, BPL and a group of allies controlling 24.6% of the bank replaced Antonveneta's board with a new one friendly to BPL. ABN Amro had tried to prevent this by asking a regional court to suspend the central bank's authorisation of BPL's stake-building, but the court said no.

All of this happened with the tacit approval of the Bank of Italy, and maybe with its help. The Bank of Italy made the Dutch wait longer than BPL for permission to raise its stake above 20%. It has not seemed at all bothered by BPL's weaker finances. A letter leaked to *La Repubblica*, a daily newspaper, suggests that the Bank of Italy also encouraged BPL to form a concert party to win the takeover. “We only talk to the banks concerned,” said a spokesman for the central bank. Consob, the Italian market regulator, is investigating whether BPL and its allies acted in concert. Separately, prosecutors are reported to be looking into the financing of BPL's putsch.

Mr Fazio's defenders say that he is guarding the close ties between Italy's banks and small business, which has long benefited from loans subsidised from banks' retail profits. Antonveneta is the dominant lender to such firms in parts of northern Italy.

The central-bank governor looks much more relaxed about another foreign bid, by Spain's Banco Bilbao Vizcaya Argentaria (BBVA) for Banca Nazionale del Lavoro (BNL). Although BNL is bigger than Antonveneta, ranking sixth in Italy by assets, it is less involved with small business.

BBVA can expect opposition from a group of property entrepreneurs at a BNL shareholder meeting on May 21st. However, most analysts think that the Spanish have a good chance of success. They might secure this by promising to help their opponents get into Spain's booming property market and by offering a top title at BNL, maybe the chairmanship, to their leader, Francesco Caltagirone.

Mr Fazio could have avoided much of the recent fuss if he had allowed strong Italian banks to consolidate at home. Instead, he blocked planned mergers in 1999. Now Italy's big banks may look abroad for partners: comments by the boss of Germany's HVB have revived talk of a possible takeover by one of these, UniCredit. And foreigners will keep trying to enter Italy, whether Mr Fazio likes it or not.

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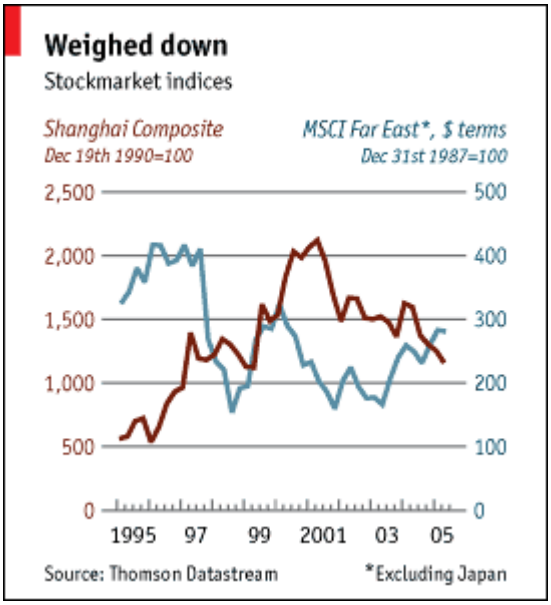
Mainland China's stockmarkets

Hangover cure

May 5th 2005 | HONG KONG
From The Economist print edition

China is finally dealing with the share overhang depressing its stockmarkets



Get article background

WHEN at last you deal with all that long-overdue paperwork, a bit of peace and quiet helps. No wonder, then, that the Chinese authorities have chosen the spring holiday, with the stockmarkets closed this past week, to confront a mountain of paper that has long bothered them: the country's state-owned shares.

Also known as non-tradable or “legal person” shares and held by provinces, cities or the central government, these account for two-thirds of the $400 billion market value of the companies listed on the Shanghai and Shenzhen stock exchanges. The threat that they will one day flood the market has helped send mainland share prices to near six-year lows, although the economy has been booming and other Asian markets have risen in the past two years (see chart). The equity market's paralysis is in turn holding back the development of other financial markets, for instance in derivatives and corporate bonds. It has also stopped the authorities raising cash to shore up China's underfunded national pension scheme.

At long last, on May 1st the China Securities Regulatory Commission (CSRC), the main stockmarket regulator, issued guidelines to deal with the overhang. As part of a trial programme, the state will start to sell shares in a small number of listed companies. In order to avoid depressing prices further, the CSRC and two-thirds of the public, minority shareholders will in each instance have to approve the conversion of non-tradable into normal shares. Moreover, buyers of the state's shares will not be able to sell for one year. In later years, they will be allowed to sell at most 5% of a company's equity.

With the markets closed, it is hard to judge how investors will react, but many will surely be pleased that the CSRC is finally grappling with the issue at all. “This is good news,” says Stephen Green, an economist at Standard Chartered, a British bank, in Shanghai. “We won't see a bull market from this, but it looks like the beginning of the end of the down market.”

Details, however, remain sketchy. The regulator has yet to name the companies in the trial, although

Shanghai Automotive, the country's leading carmaker, and steelmakers such as Wudan, Handan and Angang have previously seen their share prices rise on hope they would be fully privatised. Last month, Hainan Airlines, a regional carrier in which George Soros, a financier, holds a 14.8% stake, announced plans to sell its non-tradable shares to finance expansion and repay debt.

Another issue is whether existing shareholders will be granted pre-emption rights to buy what the state is selling, perhaps even at a discount. Overseas fund managers, who have recently started to invest more in Chinese domestic shares under the government's Qualified Foreign Institutional Investor scheme, have long argued for this, in order to minimise the dilution they will otherwise suffer.

It is also unclear whether the CSRC intends to restrict initial public offerings and secondary share issues by other companies, in order to boost demand for the state shares. Since selling $240 billion-worth of stock will take years, this could drive promising Chinese companies to list overseas. That would be an unfortunate side-effect of this long-overdue plan to revitalise China's moribund stockmarkets.

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Economics focus

Profiting from obscurity

May 5th 2005
From The Economist print edition

What the "long tail" means for the economics of e-commerce

DISRUPTIVE technologies, learning curves, tipping points—every so often a trendy new term enters the business lexicon and becomes a staple of business plans, conference speeches and PowerPoint presentations. The latest example, generating buzz among entrepreneurs, technologists and bloggers, is the idea of the "long tail". The term is not new, having long been used in statistics to refer to a feature of "power-law" distributions, such as the frequency with which different words are used in English: there are a few common words that are used a great deal, and a long tail of increasingly obscure words that are used less often. But the idea is now in vogue because of its particular relevance to the economics of e-commerce. Its popularity in this context is due to an article* published last year by Chris Anderson, formerly a correspondent for *The Economist*, who is the editor-in-chief of *Wired*, a technology magazine. The article struck a chord: Mr Anderson is expanding it into a book, and talk of long tails is becoming a venture-capital cliché. "Business plans now have to have an obligatory long-tail passage," he says. So when people invoke the long tail, what do they mean?

The short answer is a shift from mass markets to niche markets, as electronic commerce aggregates and makes profitable what were previously unprofitable transactions. Consider book sales, which obey a power-law distribution: there is a small number of very popular books, which sell millions of copies, and then a long tail of less popular books. A real-world shop can only stock so many titles on its shelves, so it generally holds those most likely to sell, at the head of the curve: even the largest bookstore carries only around 130,000 titles. But an online store, with no limits on its shelf space, can offer a far wider range and open up new markets further down the long tail. In the case of Amazon, for example, around a third of its sales come from outside its top 130,000 titles. Similarly, Rhapsody, a streaming-music service, streams more tracks outside than inside its top 10,000 tunes. Mr Anderson's point is that the collective demand for obscure items is very large, is growing, and can be aggregated over the internet, so that selling obscure books, music CDs or movies could prove to be just as lucrative as selling hits.

This has a number of intriguing implications. For one thing, opening up those previously uneconomic niche markets should increase overall demand: as people are better able to explore niches, they are more likely to find things they like, and may well consume more of them. This will then shift some demand, at least, away from hits. Indeed, the long tail reveals the hit-driven nature of the entertainment industry to be, in part, a vestige of scarcity. With limited space on store shelves, media providers are traditionally very discriminating about what they release, and use intensive marketing to generate a handful of hits. The shift towards electronic sales and distribution, however—music can already be purchased and downloaded instantly, and movies will be next—means that content providers can afford to be less discriminating. "The long tail says rather than trying to guess what the market wants, put it all out there and you'll find demand you hadn't anticipated," says Mr Anderson.

But how can people find content they want when it is buried far down the tail? Already, a number of mechanisms have emerged, based around user recommendations. Perhaps the best known is "collaborative filtering", in which purchase histories are analysed to work out what else is likely to interest the buyer of a particular product ("Customers who bought this item also bought...", as Amazon puts it). This approach allows users to navigate from hits that they know they like to more obscure titles further down the tail. "You need not just variety, but information about variety," says Mr Anderson. "A long tail without good filters is just noise." Many people find even the amount of choice on supermarket shelves overwhelming—in large part because there is so little information on which to base a rational choice. But a mere 27 flavours of jam is nothing compared with millions of music tracks or thousands of movies, so providing filters to help people find what they want is vital.

From mass market to niche nation

Perhaps the most profound implication of the long tail, however, is its impact on popular culture. As choice expands and people can more easily find niche content that particularly interests them, hits will be less important: so what will people talk about when gathered around the water cooler? In fact, says Mr Anderson, the idea of a shared popular culture is a relatively recent phenomenon: before radio and television, he notes, countries did not operate in “cultural lockstep”. And the notion of shared culture is already in decline, thanks to the rise of cable television and other forms of market fragmentation. The long tail will merely accelerate the effect. There will still be blockbuster movies, albums and books, but there will be fewer of them. The companies that will prosper, says Mr Anderson, will be “those that switch out of lowest-common-denominator mode and figure out how to address niches.”

Many successful online businesses, such as Amazon, Rhapsody or the iTunes Music Store, already exploit the effects of the long tail. So too do other internet companies, such as Google (which makes money not just by selling adverts to big firms, but also by placing obscure adverts alongside obscure web pages) and eBay (which aggregates low levels of demand for obscure products to make a huge business). Hence the venture capitalists' enthusiasm for long-tailish business plans—and, now that the term is deemed to be cool, its use and misuse in other spheres. The misuse, says Mr Anderson, is painful. But it is arguably a sign of success: the “long tail” has passed into common parlance.

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* “The Long Tail”: www.wired.com/wired/archive/12.10/tail.html

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Oncology

Nanotechnology cures cancer!

May 5th 2005
From The Economist print edition

Well, it might...

DRUG molecules not only have to be effective at treating disease, they also have to be robust enough to get from the place where they enter the body to the place where they are designed to act. Given that bodies devote a lot of effort to hunting down and destroying things that are in the wrong place—whether those things be molecules, viruses, bacteria or even errant body cells—designing drugs that can do this is no mean feat.

That is doubly true when the drug in question actually acts by stimulating one of these "thing-in-the-wrong-place" mechanisms—which is precisely how drugs that provoke a phenomenon called RNA interference work. RNAi, as it is known for short, is an approach to pharmacology that might revolutionise the field if it could be made to work routinely. It uses a natural anti-virus mechanism to block the activity of disease-causing genes, so any illness caused by the activity (as opposed to the inactivity) of a particular gene might, in principle, be treated by it.

Getting RNAi drugs into the cells that need them is, though, proving harder than people expected. So news that Siwen Hu and Timothy Triche, of the Children's Hospital in Los Angeles, and Mark Davis, of the California Institute of Technology, think they have worked out how to do so in the case of one form of cancer could prove to be an important advance.

RNAi works by mugging one of the cell's molecular messengers. The information needed to make proteins—the molecules that do most of the work in a cell—is stored as genes in the double-stranded DNA of a cell's nucleus. When a particular protein is needed, this information is copied into a single-stranded molecule called RNA. The RNA then carries the message to the places where proteins are made, and the message is translated into protein.

Many viruses work by subverting this mechanism—injecting their own RNA into a cell in order to make that cell produce viral proteins instead. But viral RNA is often double-stranded when it enters a cell, so a nifty way for a cell to deal with viral invasions is to recognise and destroy double-stranded RNA. Which is

exactly what happens. Double-stranded RNA of any variety is rapidly chopped up by most cells.

RNAi hijacks this process to stop the production of disease-causing proteins. Its drug molecules are also strands of RNA, but they are the chemical complements of the disease-causing messenger strands. That means they pair up with their targets to form double-stranded molecules, and those molecules then get chomped by the anti-virus mechanism. What has defeated researchers is getting the complement strands into diseased cells in large enough numbers. This is where Dr Hu, Dr Triche and Dr Davis come in.

Their solution is to wrap the therapeutic RNA inside a “nanoparticle” made of two polymers called cyclodextrin and polyethylene glycol, and coated with a protein called transferrin. It is the transferrin that provides the magic. Its usual job is to carry iron atoms, which cannot penetrate cell membranes by themselves, into cells. It does this by grabbing hold of those atoms and then latching on to a cell-membrane protein called a transferrin receptor, which escorts it into the cell. The researchers reasoned that transferrin and its receptor might perform the same trick for their nanoparticles, and they knew that tumour cells have more transferrin receptors than healthy ones. So they reckoned this might be a way to get the nanoparticles to concentrate in tumours. Once inside, the acidic environment of the cell would dissolve the particle, releasing the RNA.

Double trouble

To test this idea out, they injected their nanoparticles into mice that had been engineered to suffer from Ewing's sarcoma, a rare childhood cancer. They chose this disease because it is caused by a novel gene not found in healthy individuals, and thus provides a clear and unambiguous target for the therapeutic RNA. The novel gene is created when two chromosomes, numbers 11 and 22, each break in two at particular weak spots, and part of chromosome 11 joins with part of chromosome 22. As bad luck would have it, the DNA at the junction forms a sequence that the cell's gene-reading machinery recognises as a gene, and this gene spurs uncontrolled cell growth (in other words, cancer) in certain bone and muscle cells.

Mice injected with human Ewing's sarcoma cells develop secondary cancers similar to those seen in human patients. However, when the researchers injected their nanoparticles into the bloodstreams of animals with Ewing's tumours, the growth of those tumours slowed. Even better, if they injected the animals with nanoparticles shortly after injecting the cancer cells, they stopped the formation of secondary cancers in the first place.

Other scientists have shown that they can use RNAi to slow tumour growth in mice, but they have had to inject their RNA directly into the tumour, which is tricky. Dr Hu, Dr Triche and Dr Davis are the first to demonstrate that they can inject it into an animal's bloodstream and then let it find its own way to the target.

The three researchers are now working to perfect the system, so that it can be tested in people, and they are also making sure that it works in cancers other than Ewing's sarcoma. If they can do both of these things, they may have come up with the much-sought mechanism for propelling RNAi into the big time.

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Acupuncture

Does it work?

May 5th 2005
From The Economist print edition

Yes and no

ACUPUNCTURE, rooted in a 3,000-year-old tradition of yin and yang, meridians and chi, has to work hard to prove it has scientific validity. But George Lewith, a researcher at the University of Southampton, in England, who has studied the technique for 25 years, has evidence that it does. In 2004 he showed that real acupuncture has a statistically significant advantage over sham acupuncture in the treatment of arthritic neck pain. Now, he is trying to show why.

It has been known for a decade that merely anticipating receiving acupuncture has an effect on areas of the brain that release chemicals called endorphins. These are natural opiates that are involved in the suppression of pain, and this anticipation-driven response is believed to be responsible for the placebo effect—the fact that merely believing a treatment will help means that it actually does help. What Dr Lewith has now shown, in a paper just published in *NeuroImage*, is that inducing a placebo effect with acupuncture has a different effect on the brain from that of receiving actual acupuncture.

Dr Lewith and his colleagues studied 14 patients suffering from arthritis. Each was subjected, in random order, to three treatments. One “treatment” was to be jabbed with blunt needles. Patients knew in advance that this had no therapeutic value, and was there simply to set a baseline. In another treatment, patients believed they were receiving acupuncture, but in fact they were touched with sham needles that retracted into their shafts like stage daggers. The third type of treatment was actual acupuncture.

While all this was going on, the patients had their brains scanned using a technique called positron-emission tomography, which measures blood flow. During the first type of treatment, the part of the brain that showed most increase in blood flow (and hence, it is assumed, in activity) was the area associated with the sensation of touch. During the second type, there was enhanced activity in the areas responsible for the release of endorphins, too. But during the third type, a zone called the insula ipsilateral also lit up. This is not an endorphin-rich part of the brain; it is, nevertheless, believed to be involved in the inhibition of pain. Dr Lewith has thus demonstrated for the first time that the neurological effects of acupuncture go beyond the placebo effect.

That was not, however, the case in a second study published this week, in the *Journal of the American Medical Association*. Klaus Linde, of Munich Technical University, in Germany, was looking at the effect of acupuncture on migraines. He, too, used sham needles as well as real ones, though he did not do any brain scans. Acupuncture did indeed reduce headache frequency in those who received it, compared with those who did not. But it was no better than sham treatment, and therefore seemed to be acting as a mere placebo. A useful technique, then, but not a panacea.

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Spaceflight

Grounded

May 5th 2005
From The Economist print edition

The end of a successful British venture into space

AP

Toodle-pip, old thing

IN DAYS of old, when Britain still had pretensions to being a global power, the government felt that it needed the appropriate trappings, such as a space programme. Hence Skylark, a British rocket first launched in 1957.

The pretensions are long gone, and so is the space programme. These days, Britain's official interest in space (which is not much) is organised through the European Space Agency. But though grandiose dreams of extending the Empire to the moon may have vanished, Skylark lived on for almost half a century, and 440 launches, until May 2nd, when the 441st launch of a Skylark from a site near Kiruna, in Sweden, brought the curtain down on the project.

The programme's success was partly due to its modesty (the rockets were designed only to reach outer space, not to go into orbit, which requires far more powerful motors) and partly its practicality. When the British government decided to put its faith in America's space shuttle as a reliable way of carrying British experiments into space, it off-loaded Skylark to the private sector, where it continued to offer a cheap and reliable way for experiments to leave the atmosphere—in contrast to the shuttle, which is neither cheap nor reliable.

Like much British infrastructure, though, Skylark has become out of date. Its owners, Sounding Rocket Services, have decided to switch to Oriole, an American system. Dan Dare, no doubt, is turning in his grave.

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About sponsorship

Climate

Sunny side up

May 5th 2005
From The Economist print edition

More sunshine is forecast, but not everyone is happy

IF YOU have ever given in to the rose-tinted notion that the afternoons of your childhood lasted longer and that the sun shone more often, then at least one of these observations might actually be true. In recent years, researchers have confirmed a suggestion put forward in 1985, that the amount of sunlight falling on the Earth's surface is, as it were, falling—a phenomenon dubbed “global dimming”. So your childhood really was sunnier. But that might not be the case for your children. In this week's *Science*, two groups of researchers report that global dimming, which is believed to have started in the 1960s, came to a halt in the 1990s. In other words, it is now getting sunnier.

Global dimming was discovered by Atsumu Ohmura, a geographer at the Swiss Federal Institute of Technology, in Zurich. He noticed it while checking records of the level of sunlight then bathing Europe. He found that the level in the early 1980s was 10% lower than in the 1960s. Further analysis suggested that the global fall was actually slightly less than this (between 7% and 9%), while in some places, such as the Soviet Union, the drop was higher (in that particular case, 20%). But the general observation has stood the test of time.

Now, though, the process has gone into reverse. Rachel Pinker at the University of Maryland, and her colleagues, have analysed satellite records of the amount of sunlight reaching the Earth's surface between 1983 and 2001. They found it declined until about 1990, and then started rising. Overall, it increased by about 2% over the study period. And Dr Ohmura, together with Martin Wild, who also works at the Swiss Federal Institute of Technology, and several other researchers, report a large set of measurements taken at the Earth's surface which confirm the pattern.

The reason is suggested by a third paper in *Science*, written by Bruce Wielicki, of NASA's Langley Research Centre, in Virginia, and his colleagues. This uses satellite data to show a decrease in the Earth's albedo (how much sunlight it reflects back into space) from 2000 to 2004, a finding that contradicts earlier results. Much of the sunlight reflected into space by the Earth is turned away by clouds and dust in the atmosphere, and it is here that the pieces of the puzzle come together.

Last year, a group of researchers suggested that global dimming was caused by clouds getting clogged up with particulate matter such as soot. These particles act as nuclei on which water vapour condenses to form clouds. When such nuclei are rare, clouds tend to be formed of relatively few, large droplets. When they are common, many small droplets form—and lots of small droplets are more reflective than a few large ones.

Support for this idea comes from Dr Wild's detailed data on surface radiation in Europe. These suggest that the change from dimming to brightening is in line with a corresponding shift in the transparency of the atmosphere when it is cloud-free. He believes that this shift was due to a decrease in the amount of particulate material in the atmosphere. And that, in turn, he suggests, was due to more effective clean-air regulations and a decline in the economies of east European countries in the late 1980s. The pattern of brightening was also found in other parts of the world, such as North America, Antarctica, Japan and Australia. In rapidly industrialising (and dusty) India, however, Dr Wild's team found that dimming continued. Not surprising, then, that during the period of global dimming the dirty heavy industry of the Soviet Union dimmed that country most of all.

Not everyone is delighted that the sun is shining brightly again, since at first sight that might be expected to enhance the effect of global warming. In fact, it is too early to say exactly how changes in the Earth's albedo will affect the climate, since climatologists' models of albedo, particulates and clouds are still very much a work in progress. It is nevertheless ironic to note that while particles such as soot

are bad for human health, they may yet turn out to be good for the planet.

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The party that's never over

A convention for time travellers

May 5th 2005
From The Economist print edition

BBC

It is not often that *The Economist* uses its pages to pass on party invitations, but here is one that might be of interest not only to existing readers, but also to future generations. For this is a party that you may attend retrospectively. On May 7th, the students of the Massachusetts Institute of Technology plan to hold the first (and they believe only) convention for time travellers. Their reason for arguing that it is the only one is that only one is necessary. After all, time travellers of whatever period will be able to attend, provided only that news of the convention survives into any future period that might invent time travel. That may, of course, be quite a long way into the future. As the party's website puts it, time travel is a "hard problem, and it may not be invented until long after MIT has faded into oblivion". Whether the irony is intentional is difficult to say (this is MIT, after all). But for those who wish to attend without the assistance of time machines, the party starts at 8pm. The venue is East Campus Courtyard, MIT, Cambridge, Massachusetts. People of Cambridge, you have been warned.

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Modern China

Behind all the glitter

May 5th 2005 | HONG KONG
From The Economist print edition

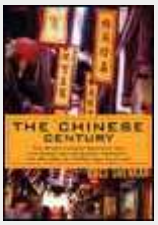
Interesting and informed books about China's rise and the global impact of its economy are not easy to come by, as three new offerings attest

CHINA'S boom—and its effect on western manufacturing jobs and consumer prices—is underlined by an array of impressive, if somewhat familiar, statistics. China now consumes 40% of the world's cement, a third of its coal and a quarter of its steel. The move of its peasants to the cities is the greatest migration in human history. Paid at less than 50 cents an hour, these disciplined workers can out-compete anyone in the world.

Oded Shenkar's succinct and thoughtful book, “The Chinese Century”, argues that the rise of China has more in common with the rise of the United States than with that of the other Asian “tigers”. China's huge domestic market quickly gave it global bargaining power. More important, it opened up early to foreign investment and trade. As a result, says Mr Shenkar, a management professor with a long interest in China, the country is rapidly climbing the technological ladder by learning and stealing from foreigners. And its large, cheap labour force means that, unlike Japan or South Korea, it can retain its cost advantage in manufacturing as it moves up the value curve. China's greater tolerance of entrepreneurship, he argues, means that its impact will ultimately be more far-reaching and sustainable than Japan's.

One can debate the technology point. The fact that China's businesses are at the mercy of government whim and political favour, and private entrepreneurs are starved of capital, has discouraged long-term research and promoted unsustainable price wars as a way of grabbing market share. Nor has China benefited as much as it might have done from foreign “technology transfer”, despite the scant legal protection offered to intellectual property. Still, Mr Shenkar makes some powerful points about China's tradition of innovation (gunpowder, paper), its readiness, unlike Japan's, to open up its educational system, and the extent to which it has benefited, again unlike Japan, or even India, from a large, rich, educated and entrepreneurial diaspora.

The Chinese Century: The Rising Chinese Economy and Its Impact on the Global Economy, the Balance of Power, and Your Job
By Oded Shenkar



Wharton; 191 pages; $25.95. FT Prentice Hall; £17.99

Buy it at
Amazon.com
Amazon.co.uk

China Inc.: How the Rise of the Next Superpower Challenges America and the World
By Ted C. Fishman

By contrast, Ted Fishman, an American journalist, is more didactic. As a readable primer, his book “China Inc.” has some appeal. But it is short on depth, favouring breathless anecdote about “what is occurring on the other side of the globe” over considered analysis. Mr Fishman admits to having made only two, albeit lengthy, trips to China, but confesses that he was told to finish the book quickly. He leans on secondary sources and seems to have interviewed more people in Chicago than in Shanghai. Mr Fishman offers a wake-up call to his fellow Americans, but ultimately he fails in his aim to demystify the country. By presenting China as invincible and its rise to superpower status as inevitable, he is in danger of promoting fear rather than understanding.

Neither book gives enough attention to China's real weaknesses: its ageing society, the fragility of its financial system, its sick capital markets, the inefficiency of its economy, its weak service sector, shortages of skilled workers and a political environment that is weighted against long-term business interests. Nor do they deal in any way adequately with the government's feeble attempts to slow its red-hot domestic economy, which stand in contrast to the aggressive way in which it recently flexed its new global muscles by bullying Japan.

For a real insider's look at life in modern China, readers should turn instead to the work of Rachel DeWoskin, who spent five years in Beijing. Hers is a personal memoir, not an academic effort. But by retelling her rather extraordinary experience and drawing lessons from the confused reactions of her Chinese friends to their changing country, she shows a society that is both immutable and developing at warp speed.

Ms DeWoskin, daughter of Ken DeWoskin, a sinologist and former University of Michigan professor, was hired by an American public-relations firm in the late 1990s and wound up as the star of a soap opera watched by 600m Chinese—the “Foreign Babes in Beijing” of the book's title. Her writing provides some effective examples of how China sees the world today—and how it thinks the world sees China. When the vegetarian Ms DeWoskin picks the pork off her noodles at lunch on her first day, her co-workers assume she grew up too poor to afford meat. She learns that the Chinese believe that westerners regard them as lazy—a conclusion that is reinforced, no doubt, by the fact that her American boss shouts and throws hamburgers at her Chinese staff. When her fellow actors call her *kaifang* or open-minded, she is flattered before realising that when applied to a young, foreign girl, the word means promiscuous.

Ms DeWoskin is at her best when recounting the contradictions of modern China. Her friends brim with optimism. They switch jobs, start businesses and crave western goods. Yet they also remain suspicious of western values, socially conservative and jingoistic. In the soap opera, the author plays a ruthless “foreign babe” who steals a nice young Chinese man from his wife. Yet by the end, his traditional family has come to accept her, partly because she genuinely loves him, but mostly because she promises to take him to America with her. Ms DeWoskin's portrait of the complexities of urban China is not uncritical. But her book is written with enormous warmth for its people. And it is all the better for avoiding neat conclusions.

Scribner; 342 pages; $26.
Simon & Schuster; £12.99

Buy it at
Amazon.com
Amazon.co.uk

Foreign Babes in Beijing: Behind the Scenes of a New China
By Rachel DeWoskin

Norton; 304 pages; $24.95

Buy it at
Amazon.com
Amazon.co.uk

The Chinese Century: The Rising Chinese Economy and Its Impact on the Global Economy, the Balance of Power, and Your Job.
By Oded Shenkar.
Wharton; 191 pages; $25.95. FT Prentice Hall; £17.99

China Inc.: How the Rise of the Next Superpower Challenges America and the World.
By Ted C. Fishman.
Scribner; 342 pages; $26.
Simon & Schuster; £12.99

By Rachel DeWoskin.
Norton; 304 pages; $24.95

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New fiction

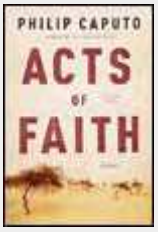
Winds of war

May 5th 2005
From The Economist print edition

AT CLOSE on 700 pages and with no fewer than four romances, each plumbed in some depth, “Acts of Faith” comes across as an African “War and Peace”. Yet Philip Caputo's prose is more pedestrian than Tolstoy's, and the novel is less epic than, well, long.

Renowned for his 1977 Vietnam memoir, “A Rumour of War”, Mr Caputo is an experienced foreign correspondent whose familiarity with the civil war in Sudan is amply on display in his sixth novel. Lavishly kitted out with sensory and technical detail, “Acts of Faith” is on authoritative thematic ground as well. Africa is a place where expedience trumps moral niceties, and where benevolence reliably boomerangs with the most woeful of consequences: nothing is so dangerous as a righteous man.

Acts of Faith
By Philip Caputo



Knopf; 667 pages; $26.95

Buy it at
Amazon.com
Amazon.co.uk

The plot involves a Christian aid organisation that buys and liberates black slaves captured by northern Sudanese Arabs during rapacious raids on southern villages. Ironically, the high prices that the Bible-thumpers pay for captives inspire more slavery, and fuel the trade. Meanwhile, a private aviation company flies aid into rebel-controlled areas of southern Sudan that have been declared no-go zones by the authorities in Khartoum, and are therefore off-limits to the United Nations.

Convinced that you can't shoot down northern gunships with a loaf of bread, the company's management begins flying arms to the Sudanese People's Liberation Army on the sly, disguising shipments of grenade launchers as aid.

Clearly “Acts of Faith” took a prodigious amount of work, not all of it wasted. Mr Caputo's plotting is skilful. When his Christian do-gooder from Iowa becomes so intoxicated by both Africa and her own virtue that she marries an SPLA commander and goes native, he echoes to fine effect not just the real life of a former aid worker named Emma McCune, but the fictional life of Kit Moresby in Paul Bowles's splendid “The Sheltering Sky”. It is gratifying to see Mr Caputo's own do-gooder get what she deserves: what she thinks she wants.

Despite its serious purpose, the novel rolls out like a rollicking adventure yarn. Yet it is excessive, and, in the end, cannot quite carry its own abundance. For those with a pre-conceived fascination for Africa and its unique perversities, “Acts of Faith” will probably prove engaging to the end. But like a three-laps-around-the-park runner on his first marathon, the more general reader may flag.

By Philip Caputo.
Knopf; 667 pages; $26.95

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About sponsorship

New theatre

Four left feet

May 5th 2005 | LONDON AND NEW YORK
From The Economist print edition

“Julius Caesar” trips up on Broadway and at the Barbican

Fiennes, but not fine

WHAT is it about “Julius Caesar” that makes it a play for today? Perhaps Shakespeare's portrait of political treachery and silken tongues tallies with a time in which heroism has given way to scepticism as the lingua franca of the age. Or maybe it is simply that a play about politicians and the people is bound to speak more directly to a modern audience than, say, an ageing magician marooned on an island (“The Tempest”) or four lovers displaced to a forest teeming with potions, fairies and a sprite called Puck (“A Midsummer Night's Dream”).

The point is that “Julius Caesar” has landed on either side of the Atlantic in two concurrent, modern-dress productions that point to its enduring appeal and, in aesthetic terms, to something else as well—namely, the difficulties that always attend the Bard, even when you've got a two-time Oscar winner like Denzel Washington to send the box office sky high.

Mr Washington's first Broadway appearance in 17 years—in other words, since he became a bona fide movie star—is the self-evident reason for the full houses at New York's Belasco Theatre, on Broadway, where takings are now roughly $600,000 a week, which is astonishing for a non-musical. Rather less astonishing is the arc of a production (from a stalwart Broadway director, Daniel Sullivan) that finds the actor cutting a commanding physical swathe as “the noblest Roman”, Brutus, without investing much in the part beyond his glittering name.

What does it cost Brutus to deliver the final, fatal wound to the dictator who in turn regards him as “Caesar's angel”? Mr Washington isn't saying. Nor for all his stage time is he remotely as affecting as Jessica Hecht in the far smaller role of Brutus's wife, Portia, whose suicide is but one of a number of deaths that push up the play's carnage rate. It is as if Mr Washington were reluctant to tarnish his own screen nobility. Unwilling to explore the anguished psychological byways of Brutus, his performance is too polite by half.

Good manners, meanwhile, are scarcely on the menu of Deborah Warner's production of “Julius Caesar” in London. And although Ms Warner's staging also features actors to reckon with—two-time Oscar nominee Ralph Fiennes as Mark Antony, for one, and the supreme Simon Russell Beale, rewardingly cast against type as Cassius—it is more what Caesar calls “the rabblement” that has made the headlines, namely the presence of more than 100 extras who swell the ranks of a play that is as much about the body politic as it is about the men who lead them.

The result lends a certain Cecil B. De Mille-style élan to an otherwise chilly evening that seems to have taken its emotional cue from the vast, arid industrial wasteland that is Tom Pye's set for the second half. As with the New York production, the conspirators are a suited, contemporary assemblage of power players, complete with laptops, with only the odd sash-like garment to suggest republican Rome of old.

Against this would-be elite, the citizenry constitute a rowdy, belligerent lot who require police barricades to keep them at bay. But the effect, while it may be numerically impressive, never really pays off. There is far more of a sense of potential insurgency in central London's Leicester Square on a Friday or a Saturday night than there is in Ms Warner's pack of carefully selected toughies.

The programme, too, contains pictures of George Bush and Tony Blair and points to the devastation

wrought in Iraq, as if that were the framework in which “Julius Caesar” is now to be found. As Saddam Hussein is hardly a modern Caesar, the parallels don't add up—and Anton Lesser's uncharismatic Brutus is merely a bore. Instead of coming to praise Caesar, one ends up nearly burying two productions that stab at the play without quite piercing its ever-beating heart.

“Julius Caesar” is at the Belasco Theatre, New York, until June 12th. Another production is at London's Barbican Centre until May 14th, and then on a continental tour to Paris, Madrid and Luxembourg until July 7th.

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About sponsorship

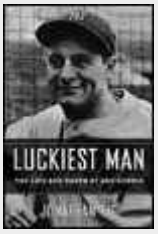
Sporting heroes

Struck out

May 5th 2005
From The Economist print edition

LATE in his playing career, Lou Gehrig suddenly won the affection he craved, and not just from fans of the New York Yankees. The American people took him into their hearts after they learnt that he was suffering from the incurable disease which has borne his name ever since. Jonathan Eig's account of how Gehrig bravely endured this terrible illness is moving even now, especially the slugger's tearful description of himself as “the luckiest man on the face of the earth.”

Luckiest Man: The Life and Death of Lou Gehrig
By Jonathan Eig



Simon & Schuster; 420 pages; $26

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Amazon.co.uk

During most of his playing career, Gehrig crouched in the shadow of Babe Ruth, both in and out of the ballpark. Never mind that he played 2,130 consecutive games for the Yankees, suffering several fractures in his hands and fingers along the way, to earn his reputation as the finest first baseman in the history of the game. Measured against Ruth, who enjoyed the limelight, fast women, fat cigars and bootleg liquor, he was a nice but dull fellow.

Other players invited good-time girls to see them play. Gehrig brought along his mother, who was memorably described by her future daughter-in-law as “formidable, built something like a lady wrestler, with yellowish-grey hair snatched back in a bun.” Gehrig was just as dutiful on the field. He arrived at the ballpark on time, did not drink, played hard, never missed a curfew, smoked mostly in private and spent his money cautiously. Yet at the age of 30, when he finally married, Gehrig still enjoyed few rewards of fame.

His shyness tied his tongue in interviews. Sports journalists grumbled that he never ever came up with a decent quote. His one big attempt to earn endorsement money by hyping the Huskies brand of cereal went hilariously wrong. When, in a live radio programme sponsored by General Foods, the presenter asked him to tell an enormous national audience whether he enjoyed any special breakfast food, Gehrig replied “a heaping bowlful of Wheaties”. Meanwhile, in the midst of the Great Depression of the 1930s, Ruth made a fortune endorsing Chevrolets, Cadillacs, Packards, Studebakers and Chryslers, as well as home appliances, boarding kennels and housing developments.

Gehrig's fine qualities came to the fore, and won national recognition, only when he was struck by a disease medical specialists call amyotrophic lateral sclerosis. Its ravages are terrible. Within a few years most sufferers are unable first to walk, then to sit up straight, to talk, to swallow and, finally, to breathe. The disease leaves the victim's brain in perfect working order, making it even harder to bear.

Inspired by his courage, more than 30,000 people wrote to Gehrig. He never gave up hope. After he was found a job as a prison parole commissioner, he continued to report for work every morning even when he could no longer hold a pen. He died at 37 and will never have a proper epitaph until a cure is finally found for the disease that bears his name.

By Jonathan Eig.
Simon & Schuster; 420 pages; $26

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About sponsorship

Professional boxing

Champ and chump

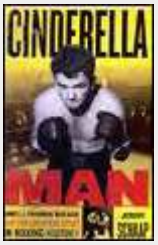
May 5th 2005
From The Economist print edition

PROFESSIONAL boxing is sometimes a renowned noble art, and sometimes just a brutal, dirty business. In this ringside history, a classic of its kind, Jeremy Schaap throws both aspects of the fight game into sharp relief with a dramatic yet intelligent account of the fall and rise of James J. Braddock and the rise and fall of Max Baer.

A year before he was given a shot at Baer's world heavyweight title in New York in 1935, Braddock was a boxing has-been; an unemployed stevedore reliant on public welfare to feed his wife and three children. The challenge he mounted for the title after three successful comeback fights was regarded as a near-joke by Baer. “Well,” he famously said, “Jimmy is a swell guy. But I guess I'll have to take him to the cleaners.”

Baer, already viewed by the public as a rich playboy, came to regret this patronising remark. In the depths of the Great Depression it served only to add to the immense sympathy that millions of Americans felt for his opponent, a family man struggling against the odds to make good. And it was their fervent support that inspired Braddock to wage the fight of his life to outpoint Baer over 15 rounds to win the title. Braddock was known ever afterwards as the “Cinderella Man”. As Baer freely admitted: “I got a million-dollar body and a ten-cent brain.”

Cinderella Man: James J. Braddock, Max Baer, and the Greatest Upset in Boxing History
By Jeremy Schaap



Houghton Mifflin; 288 pages; $24

Buy it at
Amazon.com
Amazon.co.uk

Then, as now, promoters in their pre-fight publicity exploited boxers' ethnicity for all it was worth. Baer was about as Jewish as a pork pie, yet nonetheless had a Star of David embroidered on his trunks. The public celebration of his claimed Jewishness dated back to his fight in 1933 against a German, Max Schmeling. His handlers instructed him to learn a few Yiddish words like “Oy vey” and “schmuck” and to attend synagogue, so that the match could be sold as a Jew's fight against a Nazi.

Misogyny is another unattractive side of the sport, and it was even more entrenched in the 1930s. Trainers, believing sexual activity weakened a man, insisted that their charges remain celibate while training for a big fight. The superstition was long-standing. Sam Langford, an outstanding black boxer in the early 1900s, used to swear: “You can sweat out beer and you can sweat out whiskey. But you can't sweat out women.”

Not that many women would venture into the aggressively masculine places where boxers trained. Braddock worked out mostly at Stillman's, a grim gym in the Hell's Kitchen district on New York's West Side. The gym's owner, Lou Stillman, recalled in his old age: “Big or small, champ or bum, I treated 'em all the same way—bad. If you treat them like humans, they'll eat you alive.”

The sordidness of the sport is undeniable yet somehow nobility occasionally breaks through, as it did in the savage beating Braddock suffered when he lost his title to Joe Louis. At the end of the sixth round, fearing for the boxer's safety, his manager, Joe Gould, wanted to throw in the towel. Spitting blood, Braddock told Gould that he would never speak to him again if he forced him to concede.

A couple of rounds later, Louis knocked Braddock unconscious. The final blow would push Braddock's mouthpiece through his lips, opening a cut that would require 23 stitches to close and scar him for life. Yet Braddock's only anxiety when he regained consciousness was: “Did I make a good fight?” He had lost like a champion—a cliché, but one that still counts for a lot in boxing.

By Jeremy Schaap.
Houghton Mifflin; 288 pages; $24

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About sponsorship

Amazon worldwide bestsellers

The big book index

May 5th 2005
From The Economist print edition

Bestselling sports and games books

WHO says sports fans don't read? The world's 15 biggest sports bestsellers stack up to more than 5,000 pages of arcana on every sporting subject from baseball to cricket, golf, cycling, Su Doku, bodybuilding, running and how to have yourself a better butt. For some, sport may be just a good way of spending a Saturday afternoon; for others, as one writer puts it, flexing muscle is the best way to learn about beating the curse and enjoying the game of life. Either way, these pages are all heart-stopping stuff.

1. 3 Nights in August: Strategy, Heartbreak and Joy Inside the Mind of a Manager.
By Buzz Bissinger. *Houghton Mifflin; 256 pages; $25*

What began as a conventional as-told-to bio of Tony La Russa, manager of the St Louis Cardinals, is now an enthralling account of the Cardinals' 2003 season by a Pulitzer-prize winning journalist.

Click here to buy from Amazon.com or Amazon.co.uk

2. The Plane Truth for Golfers.
By Jim Hardy with John Andrisani.
McGraw-Hill; 176 pages; $18.95 and £9.99

Everything you want to know about the two basic golf swings in use today by one of the best teachers in America.

Click here to buy from Amazon.com or Amazon.co.uk

3. It's Not About the Bike: My Journey Back to Life.
By Lance Armstrong with Sally Jenkins.
Berkley Publishing Group; 304 pages; $14. Yellow Jersey Press; £8

How testicular cancer very nearly got the Texan cyclist before he went on to win his record-breaking six Yellow Jerseys.

Click here to buy from Amazon.com or Amazon.co.uk

4. Wisden Cricketer's Almanac 2005.
Edited by Matthew Engel. *John Wisden & Co; 1,560 pages; £36*

The cricketer's bible with the distinctive yellow cover, now in its 142nd edition. The fattest sporting book on the pitch.

Click here to buy from Amazon.com or Amazon.co.uk

5. Luckiest Man: The Life and Death of Lou Gehrig.
By Jonathan Eig. *Simon & Schuster; 420 pages; $26*

The story of an ordinary man and an extraordinary athlete who died too young from the terrible disease that bears his name (see article).

Click here to buy from Amazon.com or Amazon.co.uk

6. The Times Su Doku: The Utterly Addictive Number-Placing Puzzle, Bk. 1.
By Wayne Gould. *Times Books; 176 pages: £5.99*

Learn why some people take the *Times* only for its wordless crossword.

Click here to buy from Amazon.co.uk

7. Ultramarathon Man: Confessions of an All-Night Runner.
By Dean Karnazes. *Tarcher; 288 pages; $19.95*

How to run 100 miles at a time and not keel over, by the man who states, “There is no magic in misery.”

Click here to buy from Amazon.com or Amazon.co.uk

8. The New Encyclopedia of Modern Bodybuilding.
By Arnold Schwarzenegger and Bill Dobbins. *Simon & Schuster; 832 pages; $25*

Arnold Schwarzenegger’s governorship of California may be in trouble, but he is still the bodybuilders’ number-one icon.

Click here to buy from Amazon.com or Amazon.co.uk

9. Moneyball: The Art of Winning an Unfair Game.
By Michael Lewis. *Norton; 320 pages; $13.95 and £9.99*

How to win in the Major Leagues with a budget that is smaller than that of any other team by the author of “Liar’s Poker”.

Click here to buy from Amazon.com or Amazon.co.uk

10. Idiot: Beating The Curse and Enjoying the Game of Life.
By Johnny Damon and Peter Golenbock. *Crown; 272 pages; $24.95.*

Revisiting the Boston Red Sox’s miraculous 2004 season.

Click here to buy from Amazon.com or Amazon.co.uk

11. One Magical Sunday: (But Winning Isn’t Everything).
By Phil Mickelson with Donald T. Phillips. *Warner Books; 224 pages; $22.95*

How golf’s most lovable runner-up finally won the Masters, his first major victory after 42 tries.

Click here to buy from Amazon.com or Amazon.co.uk

12. Every Second Counts.
By Lance Armstrong with Sally Jenkins. *Broadway; 246 pages; $14. Yellow Jersey Press; £8*

Volume two of the memoirs of the United States Postal Service team’s most famous biker. My, how the boy has matured.

Click here to buy from Amazon.com or Amazon.co.uk

13. Running Made Easy.
By Susie Whalley and Lisa Jackson. *Robson Press; 208 pages; $15 and £9.99*

The friendliest running book on the block, by a self-confessed hare and her friend, a self-confessed tortoise.

Click here to buy from Amazon.com or Amazon.co.uk

14. Playfair Cricket Annual 2005.
Edited by Bill Frindall. *Headline; 304 pages; £6.99*

The cricket fan's other essential book and a good complement to "Wisden". The perfect pocket fit.

Click here to buy from Amazon.com or Amazon.co.uk

15.Der Ultimative New York Body Plan.
By David Kirsch. *Riva Verlag; 270 pages; 19.90*

The fitness trainer who helped sculpt the bodies of Naomi Campbell and Linda Evangelista takes on the Germans.

Click here to buy from Amazon.de

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About sponsorship

Obituary

Ezer Weizman

May 5th 2005
From The Economist print edition

Rex

Ezer Weizman, a paradoxical Israeli president, died on April 24th, aged 80

ALL emerging nations make heroes of their founders. In Israel's national narrative as a feisty upstart battling pitiless foes, its heroes acquired the status of a makeshift aristocracy, the Founding Fathers and Homeric generals all rolled into one. Ezer Weizman was the last of that fabled breed. An embodiment of all the paradoxes of Israeliness, he was a wizard of military strategy and a reckless improviser, a hawk reborn as a dove, both dashing and coarse, statesmanlike and impolitic, ambitious but thwarted, irresistible but reprehensible in his relations with women, and a scion of the ruling class who sided with the commoner.

In Israeli terms Mr Weizman, born in the glittering, ethnically mixed northern coastal city of Haifa, had the bluest of blue blood. His uncle was Israel's beloved first president, Chaim Weizmann (Ezer was to drop the last “n”), and his grandfather, Ozer, after whom he was named, was an eminent leader of British Jewry. He and Moshe Dayan, another legendary general, married sisters.

He loved to fly, and took it up as a teenager. By 1942 he was training as a pilot for Britain's Royal Air Force when his cousin Michael, Chaim's son, the captain of a Whitley bomber, went down over the Bay of Biscay. Telling his uncle he would “take Michael's place”, Mr Weizman flew Spitfires with the RAF for the rest of the war before returning home to Mandatory Palestine to establish what would become the Israeli Air Force (IAF). In later political life he kept a cherished black Spitfire, which flew among the modern jet fighters at his state funeral.

His daring and deviousness both showed themselves early. In one of the IAF's first triumphs, in 1949, he led a sortie that—ironically—shot down five RAF Spitfires reconnoitering the Egypt-Israel border. Mr Weizman then had the Spitfires' wreckage dragged into Israel's territory to make it appear that the British had violated its airspace.

His colleagues still thought tanks were the future, not planes. But Mr Weizman's long, hard battle to secure resources for his pilots was vindicated in the 1967 war, when pre-emptive Israeli air strikes demolished the Egyptian air force on the ground, securing a stunningly rapid victory.

By rights, he should have been made chief of staff. But in a tradition that will be broken only this June, no IAF man was ever awarded the top military job. Deeply disappointed, in 1969 Mr Weizman quit the

armed forces and jumped into politics.

It was a volatile time. Israel's strutting self-confidence and Israelis' faith in the Labour governments that had always ruled them were shattered by the near-rout of the 1973 Yom Kippur war. And it was Weizman himself, the old left's favourite son, who helped deal it the fatal blow. He managed the 1977 election campaign for the right-wing Likud's Menachem Begin, and became the first Likud defence minister.

Yet his strategic stance was as pragmatic as his politics; and it was softening. Having at first advocated annexing all the lands captured in 1967, he was soon pushing to give the Sinai peninsula back to Egypt, and became an early proponent of ceding sections of the West Bank and Gaza to the Palestinians. He might have had a chance at the top job: Yitzhak Shamir, Begin's successor, offered to alternate with him as prime minister in a coalition government. But Mr Weizman rejected the offer, preferring to support the leftist Shimon Peres.

Supping with the Devil

Soon he was as radical a dove as he had been a hawk. “Let's try to talk to [Yasser] Arafat,” he said in a 1987 interview. “We have one of the best air forces in the world, we have one of the best armies in the world. What the hell are we worried about?” At the time, this was heresy. When Mr Weizman met Nabil Ramlawi, a PLO official, in 1990, breaking Israeli law, it was as if he had taken tea with an incubus. Enraged, Shamir dismissed him from the cabinet. A year later, however, Shamir himself met Arafat's envoys in Madrid. Once more, Mr Weizman had changed the paradigm.

As president from 1993 to 2000, a largely ceremonial post, Mr Weizman continued to eschew tradition by blatantly taking political sides. He was pithy, undiplomatic and had notoriously retrograde notions about women, yet he kept people's affection by being, as his daughter Michal put it at his funeral, “a prince and not a king”: patrician, but never pretentious.

Many Israelis also felt they shared the tragedy of his son, Shaul, grievously wounded by an Egyptian sniper's bullet while serving in the Sinai in 1970. Shaul's lengthy torments and eventual death in a car crash 21 years later scarred the family, as so many others had been scarred. Mr Weizman and his wife visited every soldier wounded in his presidential terms.

That common touch made him defy convention to the end. Though he had bought a house in the fancy seaside city of Caesaria, his closest ties were to Or Akiva, a poor development town nearby, where he would play backgammon in a café with the locals. He chose burial there instead of in Mount Herzl cemetery in Jerusalem—as if an American statesman had chosen a remote, small-town graveyard over Arlington National Cemetery. Only one other leader of his stature had made a similarly iconoclastic exit: his uncle, Chaim.

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Overview

May 5th 2005
From The Economist print edition

Evidence mounted that output in the **United States** is slowing. According to the “advanced” estimate, GDP grew at an annual rate of 3.1% in the first three months of 2005, down from 3.8% in the fourth quarter of 2004. The core price index for personal consumption expenditure, a closely watched measure of inflation, rose at a 2.2% annual rate in the first quarter.

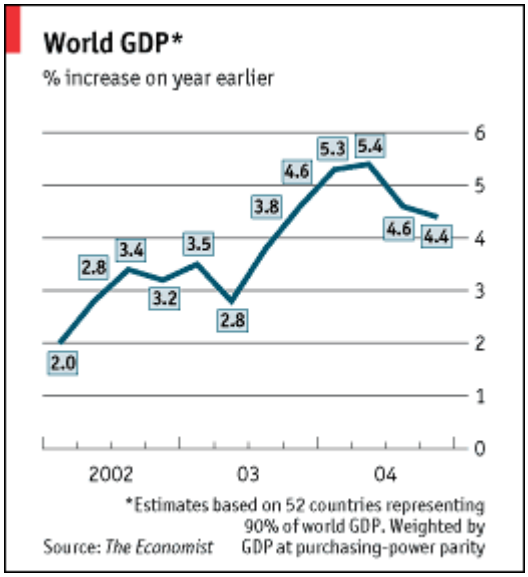
The **Federal Reserve** raised short-term interest rates by another quarter point to 3.0% on May 3rd. In its accompanying statement, the central bank noted that “the solid pace of spending growth” had slowed, but kept its hawkish language about inflation risks.

The **euro area** saw more signs of gloom. The Reuters/NTC survey of purchasing managers suggested that the manufacturing sector was shrinking. The purchasing managers' index fell to 49.2 in April, its lowest level since August 2003. A figure below 50 usually indicated contraction. The equivalent index for the services sector fell slightly to 52.8. Unemployment in the euro area edged upwards to 8.9% in March, from 8.8% the month before. But retail sales beat expectations, growing by 1.4% in the year to March.

Inflation in the euro area was unchanged at 2.1% in the year to April. On May 4th, the **European Central Bank** held short-term interest rates steady at 2.0%.

In **Britain**, too, there were signs of a slowdown. The CIPS/NTC index of purchasing managers in manufacturing fell below 50 for the first time since June 2003.

The value of **Australia's** retail sales failed to grow in March. The Reserve Bank of Australia kept interest rates on hold at 5.5%.



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Output, demand and jobs

May 5th 2005
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2005	2006	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 1.5	Q4	+ 0.6	+ 2.6	+ 3.2	– 0.4	Q4	+ 1.8	Q1	5.1	Mar	5.6
Austria	+ 2.1	Q4	+ 1.1	+ 2.1	+ 2.1	+ 4.4	Feb	+ 0.8	Feb	4.6	Apr	4.5
Belgium	+ 1.8	Q1	nil	+ 2.1	+ 2.2	– 1.0	Feb	– 2.8	Feb	12.6	Mar†	12.7
Britain	+ 2.8	Q1	+ 2.2	+ 2.5	+ 2.2	– 0.1	Feb	+ 2.7	Mar	4.8	Feb††	4.8
Canada	+ 3.0	Q4	+ 1.7	+ 2.7	+ 3.0	+ 3.8	Feb	+ 6.5	Jan	6.9	Mar	7.3
Denmark	+ 2.9	Q4	+ 3.2	+ 2.1	+ 2.2	– 4.9	Feb	+ 3.7	Mar	5.9	Feb	6.6
France	+ 2.4	Q4	+ 3.5	+ 2.0	+ 2.1	+ 1.2	Feb	+ 1.5	Mar	10.2	Mar	10.0
Germany	+ 1.5	Q4	– 0.9	+ 0.9	+ 1.5	+ 1.6	Feb	nil	Mar	11.8	Apr§	10.5
Italy	+ 0.8	Q4	– 1.7	+ 1.0	+ 1.5	– 2.5	Feb	– 0.8	Feb	8.0	Dec	8.2
Japan	+ 0.8	Q4	+ 0.5	+ 1.1	+ 1.9	+ 1.1	Mar	+ 1.2	Feb	4.5	Mar	4.7
Netherlands	+ 1.6	Q4	+ 0.1	+ 1.1	+ 1.7	+ 0.1	Feb	– 2.7	Feb‡	6.6	Mar**	6.4
Spain	+ 2.7	Q4	+ 3.4	+ 2.7	+ 2.6	– 0.7	Feb	+ 1.8	Mar	10.2	Mar	11.1
Sweden	+ 2.0	Q4	+ 1.4	+ 2.7	+ 2.7	+ 2.9	Feb	+ 8.0	Mar	5.5	Mar†	5.8
Switzerland	+ 1.2	Q4	– 0.3	+ 1.3	+ 1.8	+ 4.7	Q4	– 3.0	Feb	3.9	Mar†	4.1
United States	+ 3.6	Q1	+ 3.1	+ 3.7	+ 3.2	+ 3.9	Mar	+ 3.0	Mar	5.2	Mar	5.7
Euro area	+ 1.8	Q4	+ 0.8	+ 1.5	+ 1.9	+ 0.6	Feb	+ 1.4	Mar	8.9	Mar	8.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 3.6	Q4	+ 2.5	na	na	+ 1.1	Mar	+ 5.9	Feb	8.5	Mar†	9.5
Greece	+ 4.2	Q4	na	na	na	– 1.5	Feb	– 2.9	Jan	10.2	Dec	9.8
Iceland	+ 3.8	Q4	na	na	na	na		na		2.8	Feb†	3.6
Ireland	+ 2.8	Q4	na	na	na	– 5.7	Feb	+ 8.6	Feb	4.3	Mar	4.6
Luxembourg	+ 3.8	Q4	nil	na	na	+ 6.3	Feb	+ 2.6	Mar	4.6	Mar	4.2
New Zealand	+ 3.6	Q4	+ 2.4	na	na	+ 3.5	Q4	+ 6.8	Q4	3.6	Q4	4.5
Norway	+ 3.2	Q4	+ 6.1	na	na	– 2.0	Feb	– 2.7	Mar	4.5	Mar‡**	4.3
Portugal	+ 0.6	Q4	– 1.1	na	na	– 3.2	Mar	+ 3.0	Mar	7.1	Q4†	6.5

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Dec-Feb; claimant count rate 2.7% in Mar. §EU harmonised rate 9.5% in Mar. **Jan-Mar.

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Prices and wages

May 5th 2005
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2005	2006	latest		year ago	latest		year ago
Australia	+ 2.4	Q1	+ 2.0	+ 2.6	+ 2.7	+ 6.0	Q1	– 1.1	+ 3.0	Q4	+ 6.0
Austria	+ 2.9	Mar	+ 1.5	+ 2.0	+ 1.6	+ 4.0	Mar	+ 3.0	+ 2.2	Mar	+ 2.1
Belgium	+ 2.8	Apr	+ 1.9	+ 1.9	+ 1.7	+ 3.8	Mar	+ 2.3	+ 2.3	Jan	+ 1.9
Britain	+ 1.9	Mar*	+ 1.1	+ 1.8	+ 1.8	+ 2.8	Mar	+ 1.4	+ 4.7	Feb†	+ 4.9
Canada	+ 2.3	Mar	+ 0.7	+ 1.9	+ 2.1	+ 2.1	Mar	– 0.8	+ 2.5	Feb	+ 3.5
Denmark	+ 1.4	Mar	+ 0.7	+ 1.5	+ 1.8	+ 4.2	Mar	+ 0.3	+ 2.8	Q4	+ 3.5
France	+ 1.9	Mar	+ 1.7	+ 1.6	+ 1.6	+ 3.1	Mar	+ 0.3	+ 3.0	Q4	+ 2.7
Germany	+ 1.5	Apr	+ 1.6	+ 1.3	+ 1.1	+ 3.3	Mar	+ 1.0	+ 1.3	Feb	+ 1.9
Italy	+ 1.9	Apr	+ 2.3	+ 1.9	+ 1.9	+ 4.6	Mar	+ 0.7	+ 3.5	Mar	+ 2.8
Japan	– 0.2	Mar	– 0.1	nil	+ 0.3	+ 1.4	Mar	+ 0.2	+ 0.1	Feb	+ 2.0
Netherlands	+ 1.8	Mar	+ 1.1	+ 1.3	+ 1.4	+ 5.5	Feb	– 1.6	+ 0.9	Mar	+ 1.7
Spain	+ 3.4	Mar	+ 2.1	+ 2.8	+ 2.6	+ 5.1	Mar	+ 0.8	+ 2.6	Q4	+ 3.3
Sweden	+ 0.1	Mar	– 0.1	+ 0.7	+ 1.5	+ 2.5	Mar	– 1.4	+ 2.6	Feb	+ 3.0
Switzerland	+ 1.4	Apr	+ 0.5	+ 1.1	+ 1.2	+ 1.4	Mar	– 0.1	+ 0.9	2004	+ 1.4
United States	+ 3.1	Mar	+ 1.7	+ 2.6	+ 2.5	+ 4.9	Mar	+ 1.5	+ 2.6	Mar	+ 1.8
Euro area	+ 2.1	Apr	+ 2.0	+ 1.8	+ 1.6	+ 4.2	Mar	+ 0.4	+ 2.2	Q4	+ 2.1
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.0	Mar	– 0.6	na	na	+ 2.4	Mar	– 0.6	+ 3.0	Q4	+ 4.2
Greece	+ 2.9	Mar	+ 2.7	na	na	+ 4.1	Feb	+ 0.8	na		na
Iceland	+ 4.3	Apr	+ 2.2	na	na	+ 6.6	Apr	+ 2.7	+ 6.5	Mar	+ 3.8
Ireland	+ 2.1	Mar	+ 1.3	na	na	– 2.3	Mar	– 5.1	+ 5.1	Q4	+ 4.5
Luxembourg	+ 2.4	Mar	+ 1.8	na	na	+16.3	Feb	– 0.6	nil	Jan	+ 2.6
New Zealand	+ 2.8	Q1	+ 1.5	na	na	+ 3.4	Q4	– 0.1	+ 2.5	Q4	+ 2.3
Norway	+ 1.0	Mar	– 0.6	na	na	+17.5	Mar	+ 3.3	+ 3.9	Q4	+ 3.9
Portugal	+ 2.2	Mar	+ 2.3	na	na	+ 4.7	Mar	+ 0.3	– 0.9	Feb	+ 0.8

*New series. RPI inflation rate 3.2% in Mar. †Dec-Feb.

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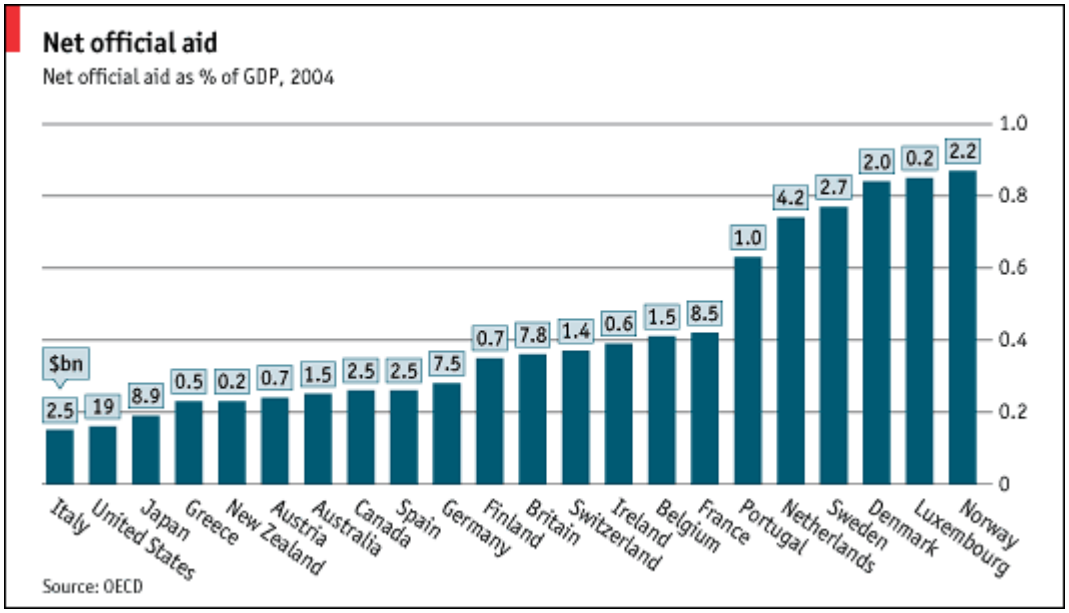
Net official aid

May 5th 2005
From The Economist print edition



Aid increased by 4.6% in real terms last year, reaching a record $78.6 billion, according to the OECD. Norway is the most generous donor to poor countries, parting with 0.9% of its GDP last year. The United States gives the most in absolute terms, providing $19 billion-worth of aid last year. But of the 22 members of the OECD's donor committee, only Italy gives less than America as a proportion of its annual income.

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Money and interest rates

May 5th 2005
From The Economist print edition

	Money supply* % change on year ago			Interest rates % a year (May 4th 2005)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 2.8	+ 8.2	Mar	5.69	5.59	5.14	5.29	5.96	6.30
Britain	+ 5.2	+10.4	Mar	4.89	4.51	4.49	4.54	4.94	5.22
Canada	+11.8	+10.8	Mar	2.46	1.94	3.06	4.19	4.92	5.58
Denmark	+15.6	+ 9.5	Mar	2.18‡	2.19	2.19	3.44	4.29	4.95‡
Japan	+ 4.5	+ 2.1	Mar	0.02‡	0.02	0.08	1.24	1.54	1.35‡
Sweden	+ 3.3	+ 3.6	Mar	1.92	2.01	2.20	3.43	4.51	3.12
Switzerland	– 5.6	+ 2.0	Mar	0.76	0.26	0.98	2.01	2.61	2.01
United States	+ 3.3	+ 4.9	Mar	3.12	1.08	3.61	4.18	4.57	5.18
Euro area†	+ 9.3	+ 6.5	Mar	2.13	2.07	2.22	3.38	4.11	3.81

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. ‡Apr 27th. Benchmarks: US 30-year 4.55%, Japan No. 269 1.26%. Central bank rates: US fed funds 3.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.75%. Sources: Bank of Canada, Commerzbank, Danske Bank, J.P. Morgan Chase, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

May 5th 2005
From The Economist print edition

2000=100

	Apr 26th	May 3rd*	% change on one month	% change on one year
Dollar index				
All items	134.9	132.3	– 0.9	– 5.5
Food	129.9	127.1	+ 0.3	–12.9
Industrials				
All	141.2	139.0	– 2.3	+ 5.2
Nfa†	129.8	129.6	+ 0.4	–10.6
Metals	147.5	144.2	– 3.5	+15.3
Sterling index				
All items	107.4	106.1	– 1.6	–10.3
Euro index				
All items	96.2	94.9	– 1.3	–11.3
Yen index				
All items	132.7	129.1	– 3.9	– 9.5
Gold				
$ per oz	435.98	427.90	+ 0.7	+ 9.2
West Texas Intermediate				
$ per barrel	54.00	49.45	–11.5	+27.1

* Provisional. † Non-food agriculturals.

Our commodity-price index was rebased in February 2005.

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Stockmarkets

May 5th 2005
From The Economist print edition

Market indices

	May 4th	2005 high	2005 low	% change on one week	% change on record high	% change on Dec 31st 2004 in local currency	% change on Dec 31st 2004 in $ terms
Australia (All Ordinaries)	3,905.5	4,255.8	3,905.5	– 2.1	– 8.2	– 3.6	– 4.4
Austria (ATX)	2,550.8	2,781.6	2,415.0	– 1.6	– 8.3	+ 4.9	nil
Belgium (Bel 20)	3,066.7	3,197.3	2,958.8	+ 0.8	–16.7	+ 4.6	– 0.3
Britain (FTSE 100)	4,882.5	5,060.8	4,783.6	+ 1.9	–29.5	+ 1.4	+ 0.5
Canada (Toronto Composite)	9,473.3	9,927.2	9,006.2	+ 1.6	–16.8	+ 2.5	– 1.7
Denmark (KBX)	279.9	294.6	257.8	– 2.0	– 7.3	+ 8.6	+ 3.4
France (SBF 250)	2,756.7	2,855.6	2,633.6	+ 1.4	–37.2	+ 4.7	– 0.2
(CAC 40)	3,987.6	4,124.4	3,816.1	+ 1.5	–42.4	+ 4.4	– 0.5
Germany (DAX)*	4,264.4	4,428.1	4,178.1	+ 1.8	–47.1	+ 0.2	– 4.5
Italy (S&P/MIB)	31,266.0	32,856.0	30,645.0	+ 1.0	–37.6	+ 1.2	– 3.6
Japan (Nikkei 225)	11,002.1	11,966.7	10,938.4	nil	–71.7	– 4.2	– 5.9
(Topix)	1,131.8	1,203.3	1,109.5	+ 0.1	–60.8	– 1.6	– 3.3
Netherlands (AEX)	351.2	379.8	347.0	+ 0.2	–49.9	+ 0.9	– 3.8
Spain (Madrid SE)	989.7	1,025.8	950.9	+ 2.1	–13.7	+ 3.2	– 1.6
Sweden (Affarsvarlden Gen)	226.8	240.4	218.9	– 0.5	–43.3	+ 2.5	– 3.8
Switzerland (Swiss Market)	6,001.9	6,030.5	5,669.6	+ 2.8	–28.7	+ 5.4	+ 0.8
United States (DJIA)	10,384.6	10,940.6	10,012.4	+ 1.8	–11.4	– 3.7	– 3.7
(S&P 500)	1,175.7	1,225.3	1,137.5	+ 1.7	–23.0	– 3.0	– 3.0
(NASDAQ Comp)	1,962.2	2,152.2	1,904.2	+ 1.6	–61.1	– 9.8	– 9.8
Europe (FTSEurofirst 300)†	1,075.0	1,107.6	1,038.6	+ 1.5	–36.9	+ 3.2	– 1.6
Euro area (FTSE Euro 100)†	909.9	952.4	894.4	+ 1.2	–41.3	+ 1.0	– 3.7
World (MSCI)‡	1,140.2	1,193.0	1,115.0	+ 1.5	–21.3	– 2.5	– 2.5
World bond market (Citigroup)††	660.6	662.3	642.6	+ 0.5	– 0.3	– 0.8	– 0.8

*Total return index. †In euro terms. ‡Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

May 5th 2005
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current-account balance $bn latest 12 mths	Current-account balance The Economist poll % of GDP, forecast 2005	Current-account balance The Economist poll % of GDP, forecast 2006	Exchange rate trade-weighted† 2000=100 May 4th	Exchange rate trade-weighted† 2000=100 year ago	Currency units per $ May 4th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2005‡
Australia	− 18.3 Mar	− 39.4 Q4	− 5.7	− 5.1	115.1	113.4	1.29	1.37	2.45	1.67	1.23	+ 0.4
Austria	− 0.1 Feb	− 0.9 Feb	− 0.6	− 0.8	105.8§	105.5	0.77	0.82	1.47	–	0.74	− 2.1
Belgium	+ 17.6 Feb	+ 12.0 Dec	+ 3.3	+ 3.3	107.7§	107.2	0.77	0.82	1.47	–	0.74	− 0.4
Britain	−107.3 Feb	− 49.0 Q4	− 2.7	− 2.7	101.2	100.1	0.53	0.56	–	0.68	0.50	− 3.2
Canada	+ 50.9 Feb	+ 23.4 Q4	+ 1.7	+ 1.5	114.4	105.1	1.25	1.37	2.38	1.62	1.20	+ 1.2
Denmark	+ 9.4 Feb	+ 7.2 Feb	+ 2.2	+ 2.1	106.3	105.7	5.75	6.14	10.9	7.44	5.51	+ 1.4
France	− 15.2 Feb	− 9.6 Feb	− 0.2	− 0.1	108.6§	108.0	0.77	0.82	1.47	–	0.74	− 3.1
Germany	+198.3 Feb	+107.5 Feb	+ 3.1	+ 3.0	110.2§	109.6	0.77	0.82	1.47	–	0.74	− 3.5
Italy	− 2.3 Feb	− 16.8 Feb	− 1.0	− 1.0	108.1§	107.6	0.77	0.82	1.47	–	0.74	− 3.1
Japan	+126.6 Feb	+169.5 Feb	+ 3.5	+ 3.6	89.4	88.6	104	109	198	135	–	− 6.4
Netherlands	+ 37.6 Feb	+ 24.1 Q4	+ 3.3	+ 3.3	108.5§	108.0	0.77	0.82	1.47	–	0.74	− 2.7
Spain	− 79.9 Feb	− 53.8 Jan	− 4.5	− 4.5	106.0§	105.6	0.77	0.82	1.47	–	0.74	− 0.1
Sweden	+ 23.0 Mar	+ 28.0 Q4	+ 6.8	+ 6.3	98.7	98.4	7.08	7.52	13.5	9.17	6.79	+ 0.7
Switzerland	+ 7.0 Mar	+ 40.8 Q4	+11.5	+11.5	107.8	106.3	1.19	1.28	2.26	1.54	1.14	− 0.6
United States	−693.1 Feb	−665.9 Q4	− 6.1	− 5.9	82.4	88.0	–	–	1.90	1.30	0.96	− 4.1
Euro area	+ 82.0 Feb	+ 50.6 Feb	+ 0.5	+ 0.5	117.6	115.1	0.77	0.82	1.47	–	0.74	− 2.6
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 13.0 Feb	+ 8.5 Feb	na	na	109.2§	108.9	0.77	0.82	1.47	–	0.74	+ 2.1
Greece	− 32.6 Feb	− 10.5 Feb	na	na	104.9§	104.6	0.77	0.82	1.47	–	0.74	− 3.5
Iceland	− 0.7 Mar	− 1.0 Q4	na	na	98.1**	90.2	63.5	73.5	121	82.3	60.9	+ 1.2
Ireland	+ 41.4 Feb	− 0.8 Q4	na	na	114.2§	113.1	0.77	0.82	1.47	–	0.74	− 0.1
Luxembourg	− 4.6 Jan	+ 2.9 Q4	na	na	107.7§	107.2	0.77	0.82	1.47	–	0.74	− 0.8
New Zealand	− 3.0 Mar	− 6.2 Q4	na	na	137.6	124.9	1.38	1.57	2.62	1.78	1.32	+ 2.1
Norway	+ 36.5 Mar	+ 34.4 Dec	na	na	108.0	106.3	6.25	6.74	11.9	8.10	6.00	+ 10.5
Portugal	− 19.2 Jan	− 13.6 Feb	na	na	105.8**	105.1	0.77	0.82	1.47	–	0.74	− 3.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, February average. ‡OECD forecast.
**IMF, December average. ††New series.

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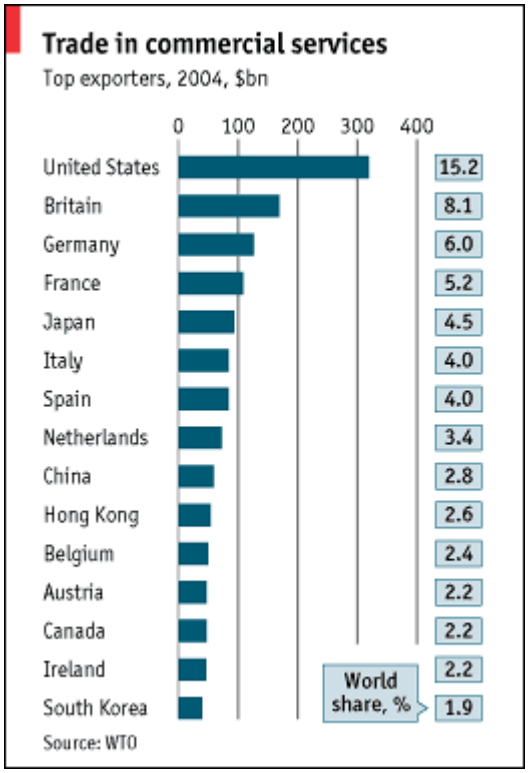
Trade in commercial servies

May 5th 2005
From The Economist print edition



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Overview

May 5th 2005
From The Economist print edition

Industrial production recovered in **Singapore** and **Thailand**, increasing by 8.3% and 7.1% respectively in the 12 months to March. In the **Philippines**, it rose by 2.4% in the year to February.

Turkey's consumer prices rose by 8.2% in the year to April, a bit faster than in March. Inflation also picked up in **Thailand**, reaching 3.6% in the year to April. Prices rose in **India** by 4.2% in the year to March.

South Korea chalked up a trade surplus of $28.8 billion in the year to April; **Malaysia** ran one of $22.8 billion in the year to March.

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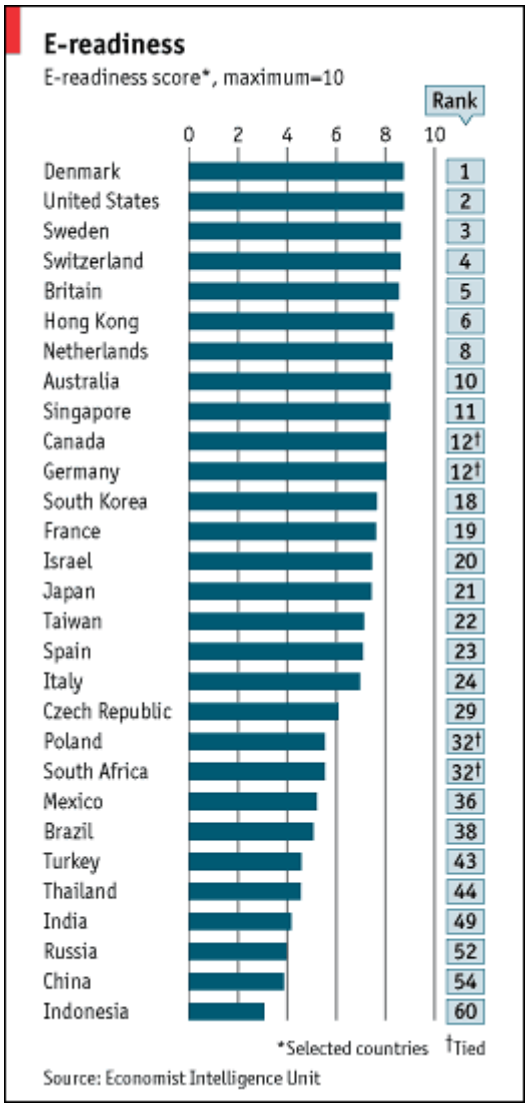
E-readiness

May 5th 2005
From The Economist print edition

Denmark is still the best place in the world to do e-business, reports the Economist Intelligence Unit, a sister firm of *The Economist*. It has ranked the "e-readiness" of the world's 65 largest economies to find the countries most amenable to internet-based business. The factors considered include broadband and mobile-phone penetration, as well as government regulation. America rose from sixth to second place in the ranking since last year. Britain fell from second to fifth place. India, despite being an IT superpower, is ranked only 49th.



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Economy

May 5th 2005
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.5	Q1	+15.1	Mar	+ 2.7	Mar	+57.3	Mar	+45.9	2003	659.1	Mar
Hong Kong	+ 7.1	Q4	+ 5.0	Q4	+ 0.8	Mar	−11.0	Mar	+16.0	Q4	122.4	Mar
India	+ 6.2	Q4	+ 4.9	Feb	+ 4.2	Mar	−26.8	Mar	− 3.9	Q4	135.3	Mar
Indonesia	+ 6.7	Q4	− 5.7	Jan	+ 8.8	Mar	+27.4	Mar	+ 2.9	Q4	35.2	Feb
Malaysia	+ 5.6	Q4	+ 8.5	Feb	+ 2.6	Mar	+22.8	Mar	+15.1	Q4	71.0	Feb
Philippines	+ 5.4	Q4	+ 2.4	Feb	+ 8.5	Apr	− 0.1	Feb	+ 2.1	Dec	13.8	Mar
Singapore	+ 2.4	Q1	+ 8.3	Mar	+ 0.4	Mar	+15.8	Mar	+27.9	Q4	112.9	Mar
South Korea	+ 3.3	Q4	+ 4.8	Mar	+ 3.1	Apr	+28.8	Apr	+27.5	Mar	205.4	Mar
Taiwan	+ 3.3	Q4	− 0.8	Mar	+ 1.6	Apr	+ 4.5	Mar	+19.0	Q4	251.1	Mar
Thailand	+ 5.1	Q4	+ 7.1	Mar	+ 3.6	Apr	− 1.8	Mar	+ 3.6	Apr	47.7	Mar
Argentina	+ 8.4	Q4	+ 5.4	Mar	+ 8.8	Apr	+12.0	Feb	+ 3.0	Q4	19.6	Mar
Brazil	+ 4.9	Q4	+ 4.4	Feb	+ 7.5	Mar	+35.9	Mar	+12.7	Mar	58.5	Feb
Chile	+ 7.3	Q4	+ 3.5	Feb	+ 2.4	Mar	+ 9.0	Mar	+ 1.4	Q4	15.4	Mar
Colombia	+ 4.3	Q4	+ 2.0	Jan	+ 5.0	Mar	+ 0.9	Dec	− 1.1	Q4	12.6	Mar
Mexico	+ 4.9	Q4	+ 2.0	Feb	+ 4.4	Mar	− 9.9	Mar	− 8.7	Q4	64.0	Feb
Peru	+ 6.8	Feb	+ 3.3	Jan	+ 1.9	Mar	+ 3.0	Feb	− 0.1	Q4	13.6	Mar
Venezuela	+11.2	Q4	+ 8.9	Jan	+15.8	Mar	+22.1	Q4	+14.6	Q4	18.8	Jan
Egypt	+ 4.7	Q4	+ 3.3	2004†	+ 6.8	Feb	− 9.0	Q4	+ 4.3	Q4	15.7	Feb
Israel	+ 4.8	Q4	+ 2.2	Feb	+ 0.7	Mar	− 7.0	Mar	+ 0.5	Q4	27.1	Mar
South Africa	+ 4.7	Q4	+ 2.7	Feb	+ 3.0	Mar	− 2.7	Mar	− 7.0	Q4	14.2	Mar
Czech Republic	+ 4.3	Q4	+ 5.6	Feb	+ 1.5	Mar	+ 0.1	Mar	− 5.6	Q4	27.5	Mar
Hungary	+ 3.8	Q4	+ 1.3	Feb	+ 3.5	Mar	− 2.9	Q4	− 8.8	Q4	17.3	Mar
Poland	+ 3.9	Q4	+ 2.1	Feb	+ 3.4	Mar	− 4.9	Feb	− 3.2	Feb	41.1	Feb
Russia	+ 4.9	Q1	+ 4.0	Mar	+12.8	Feb	+93.3	Feb	+60.1	Q4	133.7	Mar
Turkey	+ 6.3	Q4	+14.9	Feb	+ 8.2	Apr	−35.9	Mar	−16.4	Feb	36.7	Feb
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 5.8	Q4	+12.1	Mar	+ 5.0	Mar	− 1.7	Feb	− 1.4	Q4	1.6	Feb
Latvia	+ 8.6	Q4	+ 1.3	Feb	+ 6.4	Mar	− 2.8	Feb	− 1.7	Feb	2.0	Feb
Lithuania	+ 5.5	Q1	na		+ 3.2	Mar	− 3.0	Feb	− 1.6	Q4	3.6	Feb
Slovakia	+ 5.8	Q4	nil	Feb	+ 2.5	Mar	− 1.6	Feb	− 1.6	Jan	16.7	Feb
Slovenia	+ 4.3	Q4	+ 0.5	Feb	+ 2.7	Apr	− 1.6	Feb	− 0.3	Feb	8.6	Jan
Pakistan	+ 6.4	2004†	+28.3	Nov	+10.2	Mar	− 6.0	Mar	− 0.9	Q4	10.5	Feb
Saudi Arabia	+ 5.3	2004	na		+ 0.8	Jan	+68.5	2004	+28.0	2003	22.9	Feb

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

May 5th 2005
From The Economist print edition

	Currency units per $ May 4th	Currency units per $ year ago	Currency units per £ May 4th	Interest rates short-term % a year	Stockmarkets May 4th	% change on one week	% change on Dec 31st 2004 in local currency	% change on Dec 31st 2004 in $ terms
China	8.28	8.28	15.7	2.30	1,216.2	+0.9	– 8.6	– 8.6
Hong Kong	7.79	7.80	14.8	1.74	13,945.1	+0.8	– 2.0	– 2.2
India	43.5	44.5	82.8	5.10	6,289.6	+0.2	– 4.7	– 4.9
Indonesia	9,510	8,693	18,086	7.86	1,049.6	+1.7	+ 4.9	+ 2.4
Malaysia	3.80	3.80	7.23	2.82	903.1	+3.5	– 0.5	– 0.5
Philippines	54.1	55.4	102.9	5.50	1,866.2	+2.0	+ 2.4	+ 6.2
Singapore	1.63	1.68	3.11	2.08	2,149.4	+0.2	+ 4.0	+ 3.9
South Korea	1,000	1,168	1,901	3.49	929.4	–0.1	+ 3.7	+ 7.4
Taiwan	31.0	33.1	59.0	1.40	5,803.7	+0.4	– 5.5	– 3.5
Thailand	39.5	39.8	75.0	2.65	675.0	+1.6	+ 1.0	– 0.5
Argentina	2.90	2.86	5.51	4.81	1,442.1	+6.3	+ 4.9	+ 7.6
Brazil	2.47	2.97	4.71	19.51	25,474.0	+0.9	– 2.8	+ 4.4
Chile	574	622	1,092	3.60	9,310.0	+0.7	+ 3.9	+ 0.5
Colombia	2,337	2,655	4,444	7.32	4,925.1	–0.1	+ 13.3	+ 14.1
Mexico	11.0	11.4	20.9	9.77	12,643.0	+1.5	– 2.1	– 0.6
Peru	3.26	3.48	6.19	3.10	3,886.2	–3.1	+ 4.7	+ 5.4
Venezuela	2,712§	2,909§	5,158	11.80	24,289.9	–3.3	– 18.9	– 22.9
Egypt	5.80	6.18	11.03	10.31**	37,293.9	+2.5	+ 51.7	+ 58.8
Israel	4.36	4.57	8.30	na	690.9	+3.1	+ 7.3	+ 6.3
South Africa	6.00	6.85	11.4	7.05	12,671.1	–1.0	+ 0.1	– 6.0
Czech Republic	23.3	26.5	44.3	1.79	1,111.2	–2.8	+ 7.7	+ 3.3
Hungary	193	207	368	7.53	16,414.5	–2.3	+ 11.3	+ 4.1
Poland	3.24	3.92	6.16	5.56	25,856.9	–0.3	– 2.9	– 10.3
Russia	27.8	28.9	52.8	13.00	669.1‡	–0.9	+ 9.2	+ 9.0
Turkey	1.35	1.44	2.57	16.75	24,560.2	+2.0	– 1.6	– 1.8
EM (MSCI)*	1.00	1.00	1.90	na	542.9	+1.0	+ 0.1	+ 0.1
EMBI+†	1.00	1.00	1.90	na	334.1	+0.9	+ 1.4	+ 1.4

*Emerging Mkts. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate. **New series.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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